FINANCING OF
PLANNED DEVELOPMENT
IN INDIA

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PREFACE

India's experiment of carrying out its plans for economic development in a democratic set-up has been attrac ing world wide attention. But this fact, along with the Government's policy of non-alignment, has made the problem of plan financing all-the-more difficult. Availability of resources is the conditioning factor for the successful implementation of a development plan in any poor country. Moreover, the enormous financial requirement and other prevailing socio-economic conditions of an underdeveloped coun try place an unduly high responsibility on the shoulders of the Government. In the face of these difficulties plan out lays of high magnitude have been raising doubts, in the min of many, about their success.

The question of raising resources for financing eco nomic development programmes of a poor country gives rise to numerous internal as well as external problems. To find a balance between obtaining savings by cutting consumption on country-wide scale and on the other hand, trying to improve the consumption standards of the people in order to better their quality and in order to win their confidence and cooperation for the successful implementation of the plans, i also a difficult task.

But the solution is to be found out and the Governm has to do it through the instrument of public finance. Thi gives the fiscal policy a new role to perform and thus, pub

finance assumes a new responsibility in the face of the economic development of a poor country.

The financial aspect of India's plans for economic development has been a matter of great dispute. There has been vast difference of opinion on practically all major issues such as taxation, public loans, deficit financing, external loans and grants and on the total plan out-lay itself. The following work is intended to throw some light on these issues. This study covers the period during the First and the Second Five Year Plans.

This work has been divided into four parts. The first part deals with the theoritical back ground relating to the financing of economic development in an underdeveloped country with special reference to India. It brings together all theoritical aspects relating to the subject. The second part gives, as they were, the First and the Second Five Year Plans and the scheme of their financing. In the third part the main taxes and other fiscal instruments have been examined critically. The aim of such a criticism has all along been constructive and, therefore, attempt has not been made unnecessarily to elaborate issues and errors of minor importance and produce unduly enlarged pictures of the same. Economic development of a poor country is an uphill task and it requires much austerity and sacrifice from those who inhibit the country. But the task of economic development cannot be left on individuals. Under the force of circumstances prevailing in an underdeveloped country, Government has to

shoulder this responsibility and at times, much has to be don
through taxation and other measures of forced savings. Such conditions are quite likely to give rise to many oppositions and destructive criticisms. Yet, plans have to go forward without caring much for such destructive criticisms. With this view the fourth part has been added, giving conclusions and few constructive suggestions.

The total outlay of a five year plan seems to be of the first and the foremost importance -- both with the point of view of giving economy the minimum push and also in the light of country's capacity of fulfilling the target. Fulfilment of plans is something very necessary in order to win the confidence of the people. An unfulfilled plan is liable to impair people's faith in the Government and planning itsel
Secondly, fiscal instruments have to be adjusted in the light of the total requirements. An unduly high or low outlay will necessarily mean wrong handling of the fiscal instruments and thus endangering economic stability with the long term point of view. In view of this necessity a method has been suggested to fix an optimum outlay in the light of utilising the fiscal instruments at their optimum level, so as to ensure the fulfilment of plan target and a sound and productive handling of the instruments. The sole argument in this respect is that every factor of the plan should be planned in itself. A proposition has also been made to ensure the fulfilment of additional taxation target and a gradual increase of the tax-national income ratio.

Deficit financing has always been used as a passive resource for bridging the gap between the available resources and the pre-determined expenditure. It has been tried to devise a method whereby deficit financing can be used as a positive source for financing economic development. An attempt has also been made to suggest a method for obtaining savings from the non-monetised sector.

The fourth part of the present work is smallest of all the four. I have only tried to uncover the untouched aspects which I deem, are indispensable for carrying out the plans with confidence; consequently my suggestions are only few.

In putting forward my humble suggestions my young heart was greatly encouraged when my respected teacher Sri Mahesh Chand remarked that "such original propositions prepare the foreground for many a decision of vital importance in future." I take this opportunity to express my deep sense of thankfulness towards him for giving me the confidence to present this work.

It would really be difficult for me to express my gratitude towards Prof. J.K. Mehta, the unerring source of wise counsel, guidance and encouragement. It is only on account of his taking keen interest in my work that I have been able to complete it. I am also very thankful to my examiners who advanced many a constructive suggestion to improve the quality of this work. I shall fail in my duty if I do not thank my teachers Sri P.C. Jain, Sri S.K. Mukerji and Sri Saraswati Prasad who have always extended their valuable help and guidance.

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C O N T E N T S

PART I

(Theoritical aspects of financing economic development in underdeveloped countries with special reference to India)

CHAPTER I

FINANCING OF PLANNED DEVELOPMENT
A BACKGROUND

The Concept of Economic Development

Economic development of underdeveloped countries remains a matter of major concern for all the countries of the world, yet the term economic development has remained undefined and ambiguous. It is difficult to define economic development in a precise way, or to pinpoint the factors which are responsible for it. Several economists have endeavoured and interpreted it in different ways but it has been realised that no single term definition and single factor explanation can possibly be adequate. Whenever it was attempted to define this term, it immediately required a chain of further explanation and qualifications.

Earlier economists, it seems, had some intuitive understanding about the term economic development. Prof. S. H. Frankel believed that this term could not be defined and its conception lay only in the minds of particular individuals. Professor Viner, on the other hand, gave the reduction of mass poverty as the crucial test of the realisation of economic development. He definitely mistook economic development to be 'economic welfare'. Economic development is only a means and 'economic welfare' is an end, and means and end can never be one.

Latter, Alfread Marshall defined this term with sufficient success on the basis of an analogy of the biological concept of the term 'development'. According to him, economic development is a process of change whereby that, which exists potentially, becomes actual.

Friedrich List, by putting forward his famous expression that "the power of producing wealth is infinitely more important than wealth itself", gave a clue to understand what economic development may precisely mean.

An attempt at interpreting and measuring economic development involves three different categories. They are:

1. The productive capacity;
2. National income or output; and
3. Level of welfare or the standard of living.

Economic development, according to the productive capacity approach, will mean the discovery of new resources and better and improved utilisation of the existing resources of a country. In other words, this approach mean; (1) a rise in the rate of saving or capital formation to national income and (2) an increase in the capital output ratio.

It has unanimously been agreed that the best known measurable indicator of economic growth in terms of productive assets is the rate of capital formation. Economic development necessarily means that the society is shifting more and more of its current consumption resources to capital formation. This is the only accepted way that an underdeveloped and stagnant economy can be transformed into a developing or dynamic economy. It might be inferred that a country with a

higher rate of capital formation, other factors being similar, develops at a rate faster than a country where rate of capital formation is comparatively lower.

Besides, it is also desirable that the capital formed by the country by cutting or reducing the share of consumption should be productive. It should increase output to the maximum possible extent. This leads to a suggestion that economic development involves capital formation but also an increase in the capital output ratio. But at the same time, it is apprehended that the criterion of increased capital output ratio has been over emphasised in relation to the economic development of an underdeveloped country. An economy may also develop by investing on the formation of human capital, which in the short run may increase little output. Improvement in the lot of vast illiterate, weak, poor, starving, incentiveless, inactive and technically backward population is certainly necessary with the long-term point of view of country's economic development.

Then there is the national income concept of economic development. Economists have often tried to define and measure economic development in terms of the national income. Meier and Baldwin have defined[1] economic development as "a process whereby an economy's real national income increases over a long period of time." They have further added that "if the rate of development is greater than the rate of population growth, then per capita real income will (also) increase."

1. Meier and Baldwin: Economic Development; p.2.

But, this too for various reasons cannot be taken as a crucial test for economic development. Further there is quite a difference of opinion whether the national income or the national per capita income is a better indicator of economic development. Both the views have advantages and disadvantages of their own; but none of them can correctly represent or measure economic development.

Finally, there is the 'standard of living' approach, wherein it is said that an increase in national income can be meaningful only if the distribution of wealth is also affected and it gives rise to a higher consumption level. This approach suggests that the fruits of economic development should go to the common man and the standard of living of the common man should rise.

It is true that the sole aim of economic development is to remove, broadly speaking, mass poverty and mass illiteracy but it is a matter of time. Much has to be done before a tree can bear fruits.

Thus it can be seen that economic development is a phenomenon involving changes in several fields. It is probably on account of this fact that the term despite being interpreted in various ways lacks a clearcut definition. Broadly speaking, economic development can be termed as a process which ensures a new and better utilisation of resources and an increase in the economy's productive capacity for raising the standard of living of its people.

DETERMINANTS OF ECONOMIC DEVELOPMENT

Capital Formation

Economists have agreed that economic development, to a great extent, means capital formation. United Nations' experts have expressed that, "as a first approximation, it can be stated that there appears to be a high connexion between the rate of capital accumulation and rate of growth of national product."[1] "The meaning of capital formulation", as Ragnar Nurkse has explained it, "is that the society does not apply the whole of its current productive activity to the needs and desires of immediate consumption, but directs a part of it to the making of capital goods: tools and instruments, machines and transport facilities, plant and equipment - all the various forms of real capital that can so greatly increase the efficacy of productive effort."[2]

The urge for economic development arises on account of the fact that as much as 67 per cent of the world population is existing in underdeveloped regions under most pitiable conditions of living, with as little as 15 per cent of the world's total wealth at their disposal.[3] Broadly speaking, all the underdeveloped countries are primary producing, facing population pressure, have underdeveloped natural resources, inhibited with economically backward people, are capital deficient and are foreign trade oriented.[4]

1. U.N.: Economic Survey of Asia and the Far-East 1961; p.21.
2. Ragnar Nurkse: Problems of capital formation in Underdeveloped countries; p.2.
3. Ragnar Nurkse: Problems of capital formation in Underdeveloped countries; p.63.
4. Meier and Baldwin: Economic Development; p.273.

To get rid of such problems, an underdeveloped country should manage to fulfil certain basic requirements or the 'minimum critical effort', as the United Nations' experts call it.[1] Professor W.A. Lewis has pointed out three such basic requirements. They are: (1) Efforts to economise (2) accumulation of knowledge and its application; and (3) the accumulation of capital.[2]

It is clear that the modern Development Economics has accepted the indispensable role of capital formation. The absence of capital is the biggest handicap with the underdeveloped countries and capital formation occupies the central and the strategic position in the process of their economic development.

Meier and Baldwin are of the view that the accumulation of real capital in underdeveloped countries involves three independent activities; (1) an increase in the volume of real savings, so that resources that would have been used for consumption purposes can be released for other purposes; (2) a finance and credit mechanism, so that the resources may be claimed by investors; and (3) the act of investment itself, so that resources are used for the production of capital goods.[3]

Thus, the role of savings seems to be of foremost importance in relation to the economic development of an underdeveloped country. Ragnar Nurkse is prepared to take the country's incremental savings ratio, or the marginal propensity to save, as the crucial determinant of economic development.

1. ECAFE Survey 1961; p.21.
2. W.A. Lewis: The Theory of Economic Growth; p.11.
3. Meier & Baldwin: Economic Development; p.338.

He has further expressed that it is not something that takes care of itself; it does not maximise itself automatically. On the contrary, all the 'automatic' forces, including population increase, make for the additional income going into consumption.[1] It is therefore necessary that positive attempts should be made to push up the country's rate of saving in order to bring about development.

The question of magnitude of savings appears automatically with its importance. Though, requirements are liable to vary from country to country and from time to time, it has been estimated that with a rise of 1 percent in population, a community should save 4 per cent of its national income annually, to keep its per capita income from falling.[2] According to these estimates a country, where population is rising at the rate of 2 per cent annually and where two per cent annual rise in per capita income is desired, should save about 16 per cent (net) of its national income.

Generally the rate of savings which prevails in most of the underdeveloped countries has been around 5 per cent or even low. Such a low rate can not be increased to the desired level in a short time. Besides time, it requires a continuous effort to break the characteristic 'bottlenecks' of an underdeveloped country and raise the savings. It, therefore, becomes necessary that a combined effort by all the sectors of economy should be made to achieve this end. Public saving, which has been defined as the excess of Government revenue over its

1. Ragner Nurkse: Problems of Capital Formation in Underdeveloped countries; p.142.
2. Meier & Baldwin: Economic Development; p.339.

current expenditure, should rise. On the other hand private savings - including both business savings and voluntary savings by individuals - should also rise.

This brings to the use of savings. As a matter of fact, it is not only the rise in the rate of saving that is desired. Saving is only a means. It is also necessary that all the savings be put to their best use. It is generally found in underdeveloped countries that, despite their very small capacity to save, whatever little they save, goes into most un-economic forms, such as for purchase of land for prestige sake, purchase of precious metals and jewellery, luxury buildings, holding of foreign exchange assets, cash hoarding etc. Even a comparatively high rate of saving would be of little or no use ~~sue~~ in view of promoting economic development of an underdeveloped country if savings go into such uneconomic forms.

This suggests the necessity of a central mechanism to encourage saving in all the sectors of the economy and by individuals, and claim it for being spent on projects capable of developing the economy. This responsibility is to be shouldered by the Government.

Then comes the role of capital formation, which is the desired end of all savings. The chief purpose of capital development programme in an underdeveloped country is to supplement and stimulate the growth of private capital in industry, trade and other spheres of economic activities by providing basic facilities such as extension, improvement and establishment of better and more efficient means of transport and communication, electricity and power, flood control, irrigation facilities,

control over diseases and adequate health measures, extension of education and social services etc.

Capital formation may occur in agriculture, through the use of better tools and the application of fertilisers, through mechanisation, irrigation and better processing facilities etc. In the field of mining, capital can be formed through new explorations and the use of more efficient extracting and refining equipment. On the other hand, growth of light consumers industries and the establishment of heavy industries would mean capital formation in the field of industries.

There are many other important fields of expenditure which, at the first instance, may seem to be unproductive, but are indispensable for catalysing the process of development. Process of economic development involves expansion of economic activity throughout the country. To make this process smooth and rapid, it is necessary that means of transportation and communication should be developed. These projects cannot be taken up by private enterpreneurs because of their high initial costs. Thus, it becomes the responsibility of the Government to spend on public works and construct roads, dams, irrigation projects etc. and develop railways, buses, shipping services etc.

On account of the limitation of resources and the high expenditure requirement for developing different sectors there might, apparently, arise a question regarding the relative importance or priority amongst agriculture and industry. As a matter of fact there is no conflict over the importance of agriculture and industries. There is no question of choosing

between the two. Both must be developed and both should go hand-in-hand. But in countries like India, where population is large and labour abundant soundness on the food front is almost a pre-requisite. Whereas it has been agreed that agriculture and industries can not go far independently. They are complementary to each other and, therefore, both must play large and important role in the development programmes of any underdeveloped country.

The forms of capital formulation, mentioned so far, broadly represent the formulation of material capital. But, the term 'capital formulation' has generally been used in a wide sense, to include formation of human capital also. Expenditures incurred to improve the quality of people are expected to prove highly productive in the long run. Formation of human capital includes expansion of general education, technical knowledge, improved public health and social welfare facilities etc. United Nations' experts are of the opinion that "most underdeveloped countries are in the situation that investment in people is likely to prove as productive in the purely material sense, as any investment in material resources, and in many cases investment in people would lead to a greater increase of the flow of goods and services than would follow upon any comparable investment in material capital."[1] Capital formulation programmes of an underdeveloped country should thus, give emphasis on both the types of capital - material as well as human.

1. United Nations: Methods of Financing Economic Development in Underdeveloped countries; p.52.

Non-economic Determinants of Economic Development

Besides the factors already mentioned, there are certain non-economic factors which are important in determining the development of an underdeveloped country. Human activity and endeavours in social and political fields exercise a great influence on the economic development. As a matter of fact a fast rate of economic development can only be enforced by a centrally controlled plan. Individuals can neither be expected to lead the entire nation nor they will be in a position to shoulder its high financial burden. A determined Government alone can do it.

External security and internal peace and order are other pre-requisites for a rapid development. During recent years a mutual threat of war has lead most of the nations of the world to do their utmost to strengthen their defence. Consequently little is left for developing the country's economy. Similarly a suitably peaceful environment is needed, at the home front, to carry out the economic development plans. This includes the cooperation and faith of the people in the Government and in the plan.

United Nations' experts have pointed out the 'will' of people to develop as the most fundamental pre-requisite for the development. In the last place, the great task of economic development of an underdeveloped country has to be borne by the people of the country concerned. The general observation is that the poor people of an underdeveloped country, want an improvement in their living conditions, as early as

possible. But the process of economic development, can bear fruits only after a long time. This may very well disappoint people much before the economic development reaches a reasonable stage. It seems necessary that people should be prepared to sacrifice and lead a life of austerity, in the interest of bringing about a stable development in the country's economy, for quite a long time. Thus, the people factor plays an important part in determining the economic development.

Most of the underdeveloped countries (also India) are also over populated in relation to land and other existing resources; and further, the population rise is also alarming. Besides, a vast majority of this population is engaged in agricultural occupations (mainly subsistence farming) and is under-nourished, uneducated, unskilled and technically backward. Unemployment and under-employment also scales high. These factors, together with wide inequality in the incomes of a few rich and majority of poor people, create social unrest. These state of affairs while on one hand pose difficulties, make the case for economic development all the more pressing.

Financing of Development

The problem of finances is basic to the whole question of planning. The world we are living in, is highly materialistic and monatised. Hence one chief instrument with the Government for controlling activities, especially the economic activities, in a country is the instrument of raising and spending of public money. State, with the instrument of its public finance, can change the entire outlook of the society and encourage or discourage social and economic activities in the

country as it desires. This, along with the high financial requirements for capital formation make it necessary for the Government to tap all of its available resources.

"It is common knowledge that savers are not necessarily investors, and that prospective investors cannot proceed with their plans unless there are channels to assure a flow of saving to them. This is the problem of finance."[1]

In case of financing the overall economic development of an underdeveloped country, Government is the major investor, because most of the high cost and the key development projects have to be taken up by the Government. It is, therefore, necessary that savings should flow from individuals and corporations to the Government so that the investments be materialised. This is comparatively easy in the developed countries because there the portion of national output collected as taxation is ordinarily high. There Governments are more likely to finance public investment out of their own saving. But "in underdeveloped countries, the problem of finance assumes serious proportions, both because agriculture and small business dominate the economy and also because neither the Government nor the corporate sector saves enough to meet the cost of its own investment projects."[2]

In a mixed economy, where public and the private sector both are jointly carrying the task of development,

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1. United Nations: Economic Survey of Asia and the Far-east 1961; p.58.
2. United Nations: Economic Survey of Asia and the Far-east 1961; p.58.

it becomes necessary for the Government to see that the resource mobilisation by the Government does not harm the private sector. It is because of the fact that there is only one pool of country's resources for both the public and the private sector, and if the public sector draws more, the private sector is liable to starve for want of resources. In this light the task becomes to enlarge the stock of the country's resources and also to utilise them in the best possible manner. Thus, the policy in respect of the mobilisation of resources can broadly be divided into three following categories[1] -

1. fuller utilisation of available resources;
2. better or more effective allocation of the unutilised resources; and
3. gaining larger resources from untapped sources at home and abroad.

The first of the above mentioned categories deals with the enlarging of country's resources. The latter two call for the best utilisation of the available resources. This can be done by a suitable fiscal policy. It is, therefore, clear that in the face of financing the economic development of a country, Government's fiscal policy assumes a very important place.

The Government's ability to finance such an all inclusive programme of investment depends very largely on whether or not it is in a position to secure an excess of revenue

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1. Economic Bulletin for Asia and the Far-east November 1956; p.24.

over its current resources. This excess can be obtained through the budgetary appropriations of the Government, sale of stocks and bonds to the public, foreign borrowings, internal accumulations etc. These topics need independent discussions and have, therefore, been discussed in detail in the following chapters under the heads Taxation, Public Borrowing, External Assistance and Deficit Financing.

The Objectives Of Fiscal Policies

The task of the governments of underdeveloped countries in fiscal fields has undergone a radical change in the cause of being adapted to serve the main objective of promoting economic development. Fiscal policy occupies, perhaps, the most important place among policies designed to promote saving and investment, to even out fluctuations in demand and to bring about a satisfactory distribution of income and wealth.

In underdeveloped countries, public revenue amounts for only a small part of total nationa income. At the same time governments are assuming an increasing role in promoting a wide variety of developmental activities. Therefore it seems necessary that government revenue should also increase, both by way of taxation and in form of profits of public exterprises. The principle of meeting all current government expenditure by public revenue is, broadly speaking, an accepted thing. But with the assumption the responsibility of increasing the rate of investment in the economy, government should also aim at meeting a substantial part of the investments by

public savings i.e., by the surplus of revenues over current government expenditure.

The first and the foremost task of present day fiscal and monetary policies in underdeveloped countries is to secure an increase in the total of private and public savings in order to match the total of private and public investment. If this objective is achieved, monetary demand for current expenditure can be controlled to match the available supplies. It can also help the economy to grow under conditions of price stability.

This does not quite follow that the need to lower the national aggregate rate of private or personal consumption outlays necessarily calls for a decline in the current levels of consumption. The problem has, however, been presented in a way which would seem to imply that the underdeveloped countries are forced to choose between the two alternatives; either reducing consumption or reducing investment. This need not be so. At low levels of national productivity, capital imports - fertilisers for instance - could be so planned as to result in substantial rise in output in relatively short periods. While a sizable portion of these increases could be devoted to non-consumption, some share could also be devoted to allow an increase in consumption. In other words, increasing national output could provide for both the rise in the levels of living and in the rate of savings.

The financial burden of development can be lightened if saving can be secured directly in non-monetary terms; in forms such as a physical levey on product or unpaid labour for investment projects. The centrally planned economies may practice this method considerably. Savings can be raised in the

context of community development programmes and through unpaid service for public works of social or community benefit. The contribution of such services has, however, been very small.

The burden of developmental expenditure can also be lightened if the governments can practise restraint in the non-developmental expenditures of their budget. If along with the rise of revenues, the share of non-developmental expenditure also rises, it will mean that government savings are not rising as fast. This practice has been notable. In most of the developing countries it has been observed that unexpected and unforseen rises in the current non-developed expenditure of the governments has offset a substantial part of the increased government revenue which could otherwise have been used to raise the share of national investment. Besides acting to reduce the share of investment the rise of non-developmental expenditure also serves to increase inflationary pressure.

In addition to the problem of bringing about a balance between available internal resources and outlays, developing underdeveloped countries are faced with the problem of maintaining a balance between their external receipts and payments. The capacity to export of an underdeveloped country is obviously low and the nature of its exports is also primary. These state of affairs can not be expected to change in a short time. Imports in the meanwhile increase at a very fast rate following the development demands of an underdeveloped country. The indispensable imports of costly capital goods and machinery etc, can not be matched by a rise of exports. Thus the predominant dependance of developing underdeveloped countries

on imports is bound to cause sufficient strain on their balance of payments position.

The possible measures for balancing this import export gap may very well be against the policy of maintaining domestic stability. Policies designed to reduce import surpluses and bring about export increases tend to add to inflation by reducing the volume of retained output. But this can not be helped. An attempt to reduce domestic inflationary pressure by cutting exports or by allowing more imports, will definitely strain the balance of payments position and vice-versa. The best way seems to divide the total strain on both the fronts - external and the internal. The deficit on account of balance of payment can be covered by external assistance in form of loans and grants.

Among other objectives of the fiscal policies, the objective of restoring short term stability or the compensatory fiscal policy is important. Changes in the volume of production or exports, or in government and private spending cause short term fluctuations in demand. This has to be counteracted through government revenues and expenditures. These compensatory fiscal policies are different from the policies designed to raise the proportion of savings under conditions of long term stability.

One more significant aspect of fiscal policy in a newly developing country is the attempt made by the government to transfer to themselves not only the financial resources that would have otherwise been spent on private consumption but also those which would have been spent on private investment. The governments of developing countries have to aim at taking away

a part of the savings in private sector, both by taxing their savings and obtaining them as loans, with a view to ensure a better utilisation of their savings. In this respect, on one hand, it is desirable to grant tax concessions as a measure to encourage private savings in order to restrict consumption and on the other hand there is a need to ensure the best possible utilisation of the savings not only in the interest of private investing but in the interest of nation as a whole. Private sector can not be expected to use their savings on projects of national importance. Except for small personal saving, private sector saving is frequently neither lent to the government nor is it directed to priority projects. Business profits are generally ploughed back in the expansion of existing industries; only a very small proportion is spared for setting up new industries. Other saving is very often used up for investments of low priority, such as luxury housing, land possession, purchase of precious stones and jewellery, or durable consumer goods. Thus, it becomes indispensable not only to check the excessive consumption by individuals but also to transfer saving potential from the private sector to the public sector, even at the cost of private investment, to be spent in accordance with the priorities established in the interest of nation as a whole.

Finally, the fiscal system of backward and underdeveloped countries have certain social objectives among which the reduction in inequalities of income and wealth is outstanding.

It can be argued that the existence of inequality raised savings, because the rich can save higher portion of their incomes than the poor. This argument may hold true so far as the things are viewed with the monetary point of view only. A transfer of resources from the rich to the poor; and thus an improvement in the living of the vast majority of poor people, is bound to increase their future productivity. A loss of incentive to few rich can provide many fold incentive among the poor people.

The role of fiscal policy should not be construed only in relation to the needs of the government. Attention should be given to the indirect effects of fiscal policy. It should be remembered that besides its direct effect, fiscal policy also affects people indirectly. Fiscal policy should not go against the willingness and ability of individual citizens and entrepreneurs to save and invest. The objective of developmental policy is indeed to maximise the rate of saving and investment in the economy and to divert investment along the desired lines, but this should be implemented with a long-term point of view.

CHAPTER II

TAXATION

The Need

Taxation is an age old instrument in the hands of governments. Its function in ~~is~~ normal times has been to raise finances for running the administrative machinery. But this instrument has successfully been used for bringing about a desirable social order also. It is said that taxation is capable of changing the entire outlook of the people, at least as regards their behaviour towards economic life. Taxation of a particular sector tends to repel resources from the sector and a tax concession of any other sector tends to attract resources to that sector. With this capacity, taxation can and should be used as an important source for raising revenue for financing the economic development of an underdeveloped country as well as for bringing about an atmosphere congenial for its proper development.

The need for stepping up the rate of savings in a developing economy in the background of a slow response to small savings drives, limited scope for deficit financing and limited availability of external resources, make it necessary to use taxation as a measure to enforce savings in the economy.

Tax-Development Relationship

underdeveloped countries provides grounds to believe that economic development of a country is related to its tax-national income ratio. It has been observed that proportion of taxes to income in most of the underdeveloped countries is generally very low, around about 5 percent or still lower. This ratio in India during the pre-plan period was of the order of 5 percent. The developed countries like U.S.A., U.K., U.S.S.R., Australia, France etc. tax a high percentage of their national incomes. Modern industrial governments use upto 10 percent of their real resources for current purposes, apart from what they use for military purposes (which is currently even more than this) and in addition to this use from 2 to 7 percent of real resources for capital formation plus another 10 percent or so for transfers (pensions, insurance payments, interest payments etc.). Even in the case of Ceylon, the tax rate is as high as 20 percent. Hence taxation is important for economic development.

As the economic development of an underdeveloped country is a gradual process to be achieved over a long period, it may be said that the rise of tax-income ratio should be gradual. The marginal rate of taxation should exceed the average rate, that tax receipts grow faster than the national income. This is particularly necessary where inflationary measures are being used by government to raise national income. Tax rate should rise steadily with the time. The desirability of raising the tax-ratio at a steady rate makes the tax slightly difficult to handle. It should thus be handled with great caution and

in a planned manner. Consequently the implementation and imposition of additional tax should also be gradual. It should all rise smoothly and not in jerks.

Tax Objectives

It is theoritically possible to increase domestic capital formation by reducing consumption below the existing level, but at the same time it is doubtful whether it is practicable in most of the underdeveloped countries. This will all the more be difficult in a democratic set up. Thus the problem has to be approached in a different way. It is aimed to prevent the consumption from rising faster than production in the economy - and a gradual rise of production over the required consumption can be used to increase savings. At times there is also a necessity of increasing the level of consumption of some classes where standard of living is too low.

In this light the task of taxation is to keep consumption from increasing. People of middle and higher incomes are, in most of the underdeveloped countries, well known for their high propensity to consume, and there is no doubt that a fall in the level of their consumption would be in the interest of the economy. But this is not an easy task.

Apart from increasing savings by reducing consumption, it may however be possible to hold consumption at its prevailing level until production rises. The other possibility is to set the consumption level rise at a

comparatively easier to achieve. Thus the tax policy should aim at siphoning off increasing parts of the increased national income and obtain it for spending by the government. This process will help the ploughing back of income increments into further investment.

The second objective of tax policy is to fight inflation which is involved in the process of economic development of an underdeveloped country. A suitable tax policy can provide stability to the economy which is so very essential for a developing country. It acquires special significance in countries where deficit financing is being used as a measure to finance economic development.

The effect of deficit financing is, in general, to raise the incomes of poor people, who have a very high propensity to consume. The production not rising as fast results in inflation. This condition, if allowed to continue, is bound to lead the economy to a state of hyper-inflation. For this reason inflationary measures should always to accompanied by a suitable tax policy so that inflation does not persist in the economy. This can be done if taxation and deficit financing are both implemented in a planned manner and in relation to each other.

The third and one of the main objectives of tax policy in a socialist economy is to reduce the inequalities of income and wealth. To achieve this end, income and property taxes are of great help.(Though with the point of view of high taxable capacity of the country) It is, desirable to have a rich class which can pay much money as taxes with less

sacrifice on their part but for a socialistic pattern of society and high moral standard it seems just that we tax the wealthy class more and give the poor people an opportunity to improve their lot.

The main taxes are being discussed below:

Tax on Incomes

Mass poverty is a well known characteristics of underdeveloped countries including India. So it has unanimously been accepted that income taxation cannot be a very important source for public revenue. Also, like any other direct tax it cannot be used as an effective instrument to control inflation in underdeveloped countries, an overwhelming majority in an underdeveloped country is so poor that it is not possible to tax their incomes directly. In India, for example, over 82% of the total population (according to 1961 census) lives in small villages extending all over the country and the majority consists of poor people. A tax on their incomes can only make them poorer. Not only the cost of collection will be very high, it would be very difficult to assess the taxable incomes of the people belonging to the low income group.

In a developing underdeveloped country, inflation is caused by the increase in the incomes of poor people whose propensity to consume is too high. Thus their increase of income results in the rise in demand of consumption goods and some other goods of comfort. In the beginning, on account

production of the goods in demand cannot rise as rapidly as their demand rises. Here, the inability of covering the vast lower income group, makes direct taxation ineffective for controlling inflation in underdeveloped countries. For this reason income taxation can be used as an anti-inflationary measure only in developed countries where common man lives in comforts and not in poor countries where only a very small fraction of country's population can be affected by this tax.

An underdeveloped country suffers from two more handicaps which further limit the scope of income taxation. They are - illiteracy and the existence of a large non-monatised sector. As a result of these, it is neither possible for most of the people to keep correct account of their incomes nor for the Government to assess their incomes properly.

Inspite of the above mentioned reasons, importance of income tax in underdeveloped countries can not be mitigated on account of its equitable character. One of the widely accepted objectives of tax policy is to reduce the inequalities of income, wealth and consumption standards. Inequalities of income and wealth are supposed to deteriorate productive efficiency of an economy. On account of this character, specially in India where the aim is to bring about a socialistic pattern of society, income taxation acquires special significance.

United Nations' experts have expressed: "Although large amounts of revenue from personal income taxes may not

be expected during the first stages of development, such taxation is a desirable feature in any tax system since it provides an element of equity which no other tax can provide."[1]

The policy of not taxing the incomes of the low income group, on grounds of administrative inconvenience, has unanimously been accepted and has also been confirmed by experience. General opinion is, therefore, to keep the basic limit at a high level. In India, this basic level has more or less been maintained around ten times the per capita income of the country. Vast disparity in the incomes of the rich and the poor has, thus, placed over 98 percent of the people out of the income tax paying group. One more reason for maintaining high tax exemption limit and thus keeping the number of income tax payers limited is, that during the initial years of economic development, tax administration is difficult on account of the non-availability of experienced and competent staff in an underdeveloped country. Under these circumstances this tax, without loosing its importance, cannot become a major source of Government revenue.

It has also been agreed that rates of income tax should be progressive in underdeveloped countries as the

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1. UNITED NATIONS: Taxes and the Fiscal Policy in Underdeveloped Countries, p. 31.

instrument of progress proves to be of great help in bringing about equity. It is also desirable in terms of social justice and as a source of revenue.

Types of Incomes:

Taxation of incomes raises an important question. That is: whether all type of incomes should be treated as one, and taxed at one and the same rate, or a distinction should be made amongst them for purpose of taxation, according to the sources of earnings.

It has been found that in most of the under-developed countries, including India, the practice has been to tax different types of incomes at different rates. It seems justified to tax earned incomes at a rate lower than that of unearned incomes. Agricultural incomes are also taxed separately. While other income taxes are levied by the Central Government, incomes from agricultural occupations are taxed by the State Governments. In view of the largely scattered villages all over the country in India, this practice seems easier as regards the administrative control over them. Moreover, agricultural produce varies widely in different parts of the country as regards their cost and the method of its production. It would therefore, hardly be justifiable to treat so differently earned incomes as one.

Taxation of business profits etc. also deserve separate treatment. As the central problem of economic development of an underdeveloped country is to encourage productive investment - business profits definitely deserve

special consideration. Even among business investments productive investment should be treated more favourably. Production of nationally useful goods should be given highest priority. There is also need for supplementing domestic investment by foreign investment. Suitable measures are necessary to protect domestic enterprise against foreign enterprise (which is normally ~~be~~ expected to be more efficient) and yet providing foreign companies enough attraction for investing their capital in the country. Thus, the job of diverting domestic enterprise towards productive investment can only be done by a well planned and well balanced policy of business taxation.

Taxation of Business Profits

Prima facie the question arises for distinguishing between the business profits of domestic companies and the business profits of foreign companies. It has been a common practice that foreign investors monopolise some market and try to export their profits to their countries. Export of raw material by foreign corporations is also an important issue. This, not only amounts to loss of national wealth but also to the loss of productive capacity of the country.

In the past few underdeveloped countries have tried to attract foreign capital at the cost of huge revenue losses, by granting concessions. But this practice only puts domestic enterprise to great loss. Though the desirability of supplementing domestic capital

justifiable to favour foreign enterprise over the domestic one. On the contrary there are ample reasons to put an extra burden of tax on profits made by foreign corporations. Moreover dividend distribution outside the country and the export of raw material should be dealt severely so as to discourage this practice.

It has widely been accepted that taxing corporations at a flat rate would be simple. Simplicity being one of the foremost canons of taxation it would be desirable to tax the corporations at a flat rate, specially during the initial stages of development when the country can not afford to shoulder the burden of a complicated tax system. If business profits are taxed at progressive rates, it would become necessary to take into account the invested capital of the business concerned. A corporation, working with a small capital, giving a certain profit should naturally be rewarded against a corporation working with comparatively higher capital investment but making same amount of profit. But this method is liable, as already mentioned, to complicate the system. Also progressive taxation, on grounds of distribution and social justice, bears sense in case of personal income taxation but certainly not in case of corporations.

In India, corporations are subjected to two direct taxes: Income tax and the Corporation tax (super tax on corporations). Corporation tax is payable on the net profit of the corporation and the income tax is payable on the net undistributed profit. Both these taxes are charged at a

It might be repeated here that in order to ensure a steady development of an economy it is necessary that the greatest part of income increments should be reinvested. With this view the process of self financing or the practice of reinvesting the business profits into further development, deserves encouragement. It makes a case for taxing the undistributed profits at a lesser rate. This is also likely to discourage remittances of profits to shareholders living abroad. But tax concession on this account should definitely not be too much so as to reduce the share of the government, because investment needs of the government (for projects which are so very essential for the economy and cannot be taken up by private entrepreneurs) are certainly of greater importance than that of any private corporation.

Other Direct Taxes

Increasing the saving investment ratio is the central problem of economic development of an underdeveloped country. Besides the fact that the volume of savings of an underdeveloped country is low, a large part of it is held in uneconomic forms, such as luxury buildings, precious stones, precious metals, land (for the sake of social prestige), hoarded cash etc. Such savings have no productive value and, therefore, are useless for the economic development. This practice is worth being discouraged in the interest of economic development. This end can be achieved by taxing such uneconomic holdings, so

that they may become costly enough for an individual to retain.

With this view a tax on the net wealth came into existence. It is easy to understand that wealth tax is of greater importance in order to bring about an equitable distribution in the economy than the income tax. This tax is easy to administer also and involves little complication. Thus, considering equity, utility, administrative efficiency and revenue point of view, a tax on net wealth seems of great significance.

Next comes the case of an Estate duty. Transfer of property to the heir after the death of an individual raises few relevant questions. This practice bestows upon the heir of the property a fortune without his making any effort to deserve or acquire it. It gives the heir an extra economic backing. On the other hand if such a transfer of property be taxed it would only reduce the magnitude of wealth coming to heir and in no way amount to a burden on him. On grounds of experience too, it seems justifiable. Sudden transfer of property into the hands of young heirs has many a time resulted into loss of incentives in them and consequently to decay of the inherited wealth. Under these circumstances the claim of the government, to tax a portion of the inherited property to use it in the interest of nation as a whole, cannot be denied.

Rate of death duty raises possibly a very difficult question. It can only be said that the rate can only depend

followed. A completely capitalist or a lassiez-faire economy may not tax such a property at all while on the other hand, in a completely socialist administration the property after the owner's death, might be confiscated. In India, with its midway policies, a middle path can be recommended. While it hardly needs special mention that small properties should not be taxed on grounds of administrative inconvenience, big properties should be taxed progressively.

In order to check the evasion of death duty, by gradual transfer of property to the heirs by the owner before his death, Mr. Nicholas Kaldor suggested that the estate duty be replaced by a general Gift tax. He also recommendedthat the tax be levied, not on the value of the property thus transferred but, on the value of the property of the recipient (including the property received by him). This, he argued, represented the real taxable capacity of the tax payer.

India has partly accepted Prof. Kaldor's suggestion and a tax on 'Gifts' has been introduced, but estate duty continues to exist separately. Prof. Kaldor's suggestion of taxing the transferred property in relation to the value of the property of receiver distorts the main aim of the tax. In that case it is liable of becoming another type of wealth tax, being charged according to the 'ability to pay' of the tax payer. In this manner the wealth of the gift receiver is who also pays wealth tax, is liable to be doubly taxed in a sense. According to this method gift receiver becomes

the tax payer. On the contrary the idea behind a death duty is only to limit the right of an individual to pass his property after his death. Actually the owner is supposed to be the tax payer. Heir is supposed to pay the tax, out of the property received by him from the owner, on behalf of the owner. On these grounds the method adopted in India seems correct.

Taxation of Agriculture

Indian economy is largely agrarian in character. Something of the order of 50 percent of India's national income is contributed by agriculture and a still higher percentage of population lives on earnings from land. In such a case a tax on agriculture is bound to affect an over whelming majority of population and thus, it deserves special care as its effects are bound to be far reaching.

As regards the methods of taxing the agricultural sector it has been accepted that no method prevailing in some other developed country can be found suitable and, therefore, adopted because farming practices differ widely from land to land. There can, therefore, be no homogenous system of agricultural land even for India as a whole, where farming differs on account of the variability of fertility, produce and the method of farming.

Agricultural land in India, like most of the under-developed countries, is divided into small holdings on which there is sufficiently high pressure of people who ~~submit~~ subsist upon its earnings. Thus, there is a wide agreement on the

of income should be exempted from taxation. A tax on farmers living on or below the subsistence level is bound to affect adversely the productive capacity of the land and the people.

Coming to the taxation of bigger land holdings a taxation of land seems to be an important source of getting revenue. Tax on land can easily be assessed and collected. the justification for levying a tax on land is that during the process of econom c development real value of land increases and government can tax a part of the increased value. It has also been agreed that this tax should be levied on a progressive basis.

Purchase of land for speculative purposes and for the sake of social prestiage, is a common practice in underdeveloped countries. Rich land owners are liable to use their land uneconomically. They may keep it completely idle. Such lands should be taxed at a higher rate. Capital gains tax is also likely to discourage such a practice.

Finally, farming corporations, it has been agreed, should be taxed like other business corporations.

Indirect Taxation

In view of the ineffectiveness of direct taxes to control inflationary and deflationary tendencies and their narrow coverage of tax revenue, economically underdeveloped countries have to rely, to a great extent, on indirect taxes. Indirect taxes have thus two primary objectives - (1) to combat inflation and (2) to raise sizable revenue for

investment by the government. Indirect taxes are levied in various forms in view of easy tax administration, revenue possibilities, consumption habits and the conditions of production and demands of # certain goods. Excise duties, customs, sales taxes, tax on entertainment, betting, advertising etc. are a few modes of levying indirect taxes.

Commodity Taxation

Indirect taxes are capable of reaching that overwhelming majority of people who fall out of the limited income tax paying group. One of the fundamental prerequisites for the economic development of an underdeveloped country is the will of the people to develop and thus, all people have a moral duty to contribute towards the development efforts. It becomes desirable to tax the majority to get their little bit towards the developmental efforts.

Commodity taxation, on account of its majority covering character, produces far reaching effect on the economy. As the process of economic development involves an increase in domestic production as well as the expansion of monetised sector, it proves to be a sufficiently revenue yielding source. If along with the increased domestic production old rates are increased and new commodities, are also added to the list of taxable commodities, yields all the more increase. Though with the government point of view its administration is not very easy yet it has to be done in the interest of country's economic development.

Inflation is caused by the rise in the incomes of the poor and the middle class people who are well known for their tendency to conspicuous consumption; and there is no doubt that efforts to check additional consumption by them would be in the interest of the nations as a whole.

Further, commodity taxes are very much effective in changing the consumption habits of the people. There are several non-essential articles which are in common consumption, even by the poor people. The consumption of tobacco, betel, spices, liquors and other intoxicants etc. claim a handsome share of the income of a large number of people. A tax on such articles and an over-all reduction in the purchasing power of the consumers by taxation of other articles is liable to improve the consumption pattern of the people. One thing is certain that the articles of necessity such as food etc. should not be taxed. The demand for the articles of such essential nature being inelastic, their taxation will be regressive in character and will definitely be opposed.

It is sometimes argued that the effect of commodity taxation is to penalise the domestic producer, who works to increase the economy's productivity. The argument is only one sided. Taking the picture as a whole its effect is certainly not to penalise the domestic producer but only to take a part of the profit for spending in the interest of the whole of the economy. This tax is also of great importance because it can be used as a tool to improve the pattern of production of the economy. An underdeveloped country with

its limited resources can hardly afford to spend on luxurious goods and other non-essential commodities. Production of nationally useful goods and commodities can be encouraged by taxing them at a rate lesser than that on the non-essential and luxury goods.

General sales tax is another important form of indirect taxation. On account of a general rise in the purchasing power of the community and increased consumption in the economy (on account of increased production, increased population, increasing trend towards urbanisation and increased national income) a tax to hold the consumption expenditure from rising fast, that is a general sales tax, becomes necessary.

It has been agreed that selective excise duties and the general sales tax both should be used in the economy. Their functions though at the first sight may appear to be similar are different. Selective excise tax proves helpful in improving the pattern of production and consumption in the economy, while general sales tax is used to restrict consumption in general. That is why, a combination of the two is thought to be suitable for an underdeveloped economy.

Sometimes it is advocated that in view of obtaining revenue conveniently or with some other specific intention excise tax may be extended to an essential commodity also. It is argued that every tax need not be equitable in character, what is needed is that the tax system as a whole should be equitable. A tax system may remain equitable

despite of the existence of both the equitable and regressive taxes in the economy. On this ground a tax on salt, which existed in India during preindependence days, has many a times been suggested. There does seem enough justification for such a tax, but in a democratic country like India such a tax is liable to be opposed and it is quite possible that the opposition groups may exploit the opportunity to serve the confidence to masses in government.

Customs

Import and export duties have remained an important source of government revenue during the pre-independence days in India. But since the augmentation of planned development in the country they have lost their relative importance. Revenues from custom duties have remained more or less static over the planned development period in India, while the union excise duties experienced a six fold rise.

Import duties may be considered as a paying source for earning revenues and at the seme time their administration is also relatively easy. But on account of tight balance of payments conditions resulting from increased imports of capital goods and machinery during the economic development of an underdeveloped country, it becomes necessary to restrict, as far as possible, the import of consumer goods. On the other hand the imported capital goods, machinery etc. can not be taxed because they are so very essential in view of the country's development.

Import of consumer goods also deserves discouragement in view of protecting the infant domestic industries against foreign competition. With declining imports, import duties can not be expected to ~~pa~~ play any important part in getting revenues for financing the development.

The position of export duties is almost similar. Like import duties the main advantage of export duties also, is that they are administratively easy to collect. Special profits arising from sudden rise of prices in foreign markets, provide an attractive field for taxation. Another advantage of this tax is that, it can be paid out of the profits earned abroad. Its impact can also not be transferred on the foreign purchasers. It directly taxes the profits of the exporter. Thus, in nature, it is similar to the income tax and should, therefore, be levied on a progressive basis.

Export duties can not be relied, as a source of obtaining revenue for financing economic development, as the yields greatly depend on the fluctuations of the world markets. Secondly, the problem before a developing underdeveloped country is to encourage exports in order to ease its deteriorating balance of payments position, for which at times concessions and subsidies have to be granted. As a whole the role of export duties is to supplement incometax in dealing with the profits arising from exports.

<u>Taxation and incentives</u>

The extent of reliability on income tax and the

of its effects upon incentives and savings. A strong will of the people to develop and a rise in the savings are known to be of greatest importance for a developing under-developed country. Effect of taxation on savings has special importance in such countries. The class which is easiest to tax in the less developed ~~es~~ economies is the landlord class, because in their case neither savings nor incentives are involved. The poor class it seems has to carry a very high tax burden but in demecratic countries like India, where they exercise a right to vote, with the political point of view it becomes difficult to tax them and earn their disfavour. Similarly salaried and the middle class are also difficult to tax. During the process of development the incomes of business and labour classes rise and ~~ed~~ the income of the salaried class does not rise. Thus taxation hits the real incomes of the salary earning class. The existence of this class is important because this class produces skilled and semiskilled workers, doctors, engineers, teachers and people to work in other profession, who are greatly needed in a developing economy.

Taxation of profits seems also quite difficult. Its effect may not have much effect with the political point of view, especially in case of a foreign body, but it certainly may damage both incentive and savings. Here the saving point is not so important because a loss of private savings can be covered by an equal rise in public savings, but the incentive point of view is of great importance because entrepreneurship is scarce in underdeveloped countries.

For this reason sometimes it is advisable to grant tax concessions to the capitalists who start new industries.

The taxation of the commercial and the industrial class is also difficult because these classes are greatly responsible for private savings and production. During the initial stages of economic development a large part of national income rise goes to this class in the form of profits and it makes the few individuals of this class richer. It can easily be understood why this practice should not be allowed to continue. On the other hand if profits are taxed heavily and so reduced to low levels private savings may diminish and the incentive for private enterprise may be reduced.

The liberal way to deal with this problem is to tax profits lightly and encourage private entrepreneurs to make profits during their lifetime and tax them severely after their death. This process will provide them enough incentive to produce, earn and increase personal savings but after their death, its major part will be transferred to the public sector. This scheme will also provide each generation to start with more equal opportunities and provide more incentives.

~~However~~ Howsoever painful the act of taxation may be, it has to be borne by the people of a developing underdeveloped country - by rich and the poor alike. But it is, never the less, important to remember that the taxes should provide for maintaining incentive for productive

Tax Evasion and Administration

On account of narrow coverage of tax revenue and the enthusiasm to increase the volume of tax receipts generally tempts the ~~tax~~ administration to add new taxes and put supplementary rates on top of the old ones. This, together with the slack administration of taxes, gives rise to the practice of fairly wide tax evasion. Tax payers, in general, can not be expected to have the consciousness of paying taxes by themselves. The reason is that in the first place, most of the people do not maintain proper accounts of their income and expenditures and secondly the prevailing high tax rates drive them to evade the payment of taxes as far as possible. Especially in India, a country which gained independence after centuries of slavery, people in general can not be expected to have that much of national character so as to value their moral duty of paying taxes over their personal interest. That is why the taxes, direct taxes in particular, are said to be a tax on honesty. Honest persons have to pay taxes while dishonest ones manage to avoid it.

As a result of tax evasions, when the loss of revenue is tried to be filled by increased taxation, evasions increase and thus the system is liable to get into the grip of a vicious circle of tax evasion. Therefore, obviously the remedy of revenue losses on account of evasions is definitely not the tax increase. It calls for dealing with the practice of evasions directly.

It is understood that taxes, direct and indirect both, are evaded on a large scale in India and according to

Dr. Kaldor its magnitude in India could be of the order of Rs 300 crores.[1]

From the side of administration, one of the reasons of tax evasion is the absence of trained, competent and, one would be inclined to say, honest machinery for tax administration. In order to check such a practice while on the one hand there is pressing necessity for training the staff and strengthening the machinery, it can not be denied that it is necessary to deal with the dishonest elements in a strict manner. While there is need for maintaining moderate rates of taxes in the economy it is also necessary that they should be paid honestly. The cause of economic development being of national importance, such defaulters should be treated as traitors. Tax evasion should be made a criminal offence and tackled with strong hands.

CHAPTER III

PUBLIC BORROWING

The importance of saving in relation to the economic evelopment of an underdeveloped country has already been discussed n the foregoing pages. It has been agreed that a country's apacity to develop is, to a great extent, conditioned by its apacity to save. Savings play an important part, not only in eveloping an underdeveloped economy but also in maintaining the evel of economic development in any developed economy.

It has also been mentioned that only a high rate of aving is not enough, its productive utilisation is also necessary. t is, therefore, desirable that all non-invested savings should low to the investors. In the case of a developing underdeveloped conomy, the Government has to shoulder the responsibility of tepping up the investment rate, and the scope for enforcing avings through taxes and other methods is always limited as ompared to the financial demand of development. Thus, it becomes ecessary for the Government to borrow from the public in order o supplement its meagre revenue surplus.

Amount, which a Government borrows from the public, ay broadly be divided into two categories:-

1. Small Savings 2. Market Loans.

Both the above mentioned categories are similar in he sense that both increase the liability on the Government. ut they are different in character. Receipts under the head Small Savings' comes in form of voluntary savings from those

ho are supposed to have very little capacity to save or no aving capacity at all. This class consists of a very large ercentage of the population of a poor country. Savings, from his class, generally, amount to a net decrease in the country's onsumption. On the other hand the receipts under the head of Market Loans", come from those who already have a reasonable aving capacity and they are not investors themselves. Their avings, when they are borrowed by the Government, do not amount o a rise in the economy's rate of saving. It only means a ransfer of investment resources from the private sector to the ublic sector. Such a transfer is desirable because it attracts esources for being spent on projects of national importance, which therwise would have remained idle or would have been spent on rojects of lesser importance.

mall Savings.

It is common knowledge that a very large percentage f the population of an underdeveloped country lives on or even elow the level of subsistence. This is so common that mass overty becomes one of the characteristics of an underdeveloped conomy. Initial efforts of economic development and the policy f redistribution, transfer a rising percentage of increased ational output to this lower income class, which has a very high ropensity to consume. Under these circumstances additional ncome is liable to go into consumption, and to give rise to nflation in the economy. It becomes necessary to introduce the abit of saving among the people of this class, in order to keep a check on the over all consumption in the economy. Besides

xation, this can be done by encouraging voluntary savings by
e individuals.

Inspite of the indispensable place of savings, there e several factors which limit its availability in underdeveloped untries. Its cause can be explained by looking into the factors ich affect savings in an economy.

Saving in an economy is the result of two fundamental ctors, namely (1) the income factor; and (2) the people factor. the first place, savings are affected by the total wealth ailable in the economy. If total wealth in the economy is small, would only be possible to save in small magnitude and if, on the her hand, a country possesses much wealth, more savings can be tained. Secondly, it is the people factor which affects the lume of savings. As ultimately people are to select between e choice of consumption or saving their social,psychological and mperamental outlook will also determine the volume of saving in e country.

Both these factors, in an underdeveloped country are ich, that ~~they~~ they affect savings only adversely. National income of underdeveloped country, by its very definition, is low; and condly its population is, in general, uneducated and backward. us, both these fundamental factors make the atmosphere which is t congenial to encourage the habit of savings.

stacles to Savings.

Before adopting measures to mobilise savings in underveloped countries it is desirable to consider, in detail, those ctors which serve as obstacles in this respect. Obstacles to vings may be summed up as follows -

(1) Countrywide poverty and the fact that a major art of population lives at or even below the level of subsisence;

(2) Sharp division of society into rich and the poor lass that tempts the poor to consume even more;

(3) The fact that vast land ownership and buildings tc. are considered as means of social prestige in underdevelopd areas;

(4) People's affinity towards precious metals and ewellery etc.;

(5) People's attachment to cash holdings;

(6) Wide spreading illiteracy and consequently the ack of foresight and lack of national outlook among people;

(7) Existence of limited monetised sector and a vast on-monetised sector; and

(8) The inadequacy of existing savings institutions, o encourage and mobilise savings out of the widely scattered esources.

The most important among all factors given above, is he widespread poverty in an underdeveloped country which bars he possibilities of increasing savings at the very forefront. avings in such countries come out of the limited class of very ew individuals who are rich and can save. The remaining class f poor people which is comprised of vast majority of country's opulation, practically saves nothing or even dissaves.

Besides, an underdeveloped country has a high ropensity to consume. It has the desire of more and more onsumption and this desire is further increased for the reason hat poor people try their best to live and enjoy like rich ones

.fference between the standards of living of the poor and the .ch poses another obstacle before savings.

In addition to the limited scope for savings in nderdeveloped countries, a good deal of it goes into most uneconomic and undesirable forms such as land holdings, real states, purchase of jewellery, cash hoarding etc. This is oubtlessly the result of short sightedness and the absence of ational out-look amongst the people. The psychological factor an be accounted for the lack of education among the people of nderdeveloped countries. People have great affinity for recious metal and for landed properties etc. on account of the revailing social traditions and beliefs. Besides, they do not now any better use of their savings. They are short of techniues and skills, and incentive and entrepreneurship.

One more factor, which limits the scope for obtaining nvestable savings, is the existence of a vast non-monetised ector in the underdeveloped countries. A vast section of eople mainly living in rural areas and employed in the agriculural sector, has very little to do with money. Agriculture, o most of them, is hardly anything beyond subsistence farming. hey produce and they consume. Barter system still prevails t many places and thus, they can hardly add anything towards he saving demands of economic development.

Savings in relation to economic development means omething more than merely not consuming. It suggests its roper utilisation for the formation of capital, and especially he productive capital. Individuals in their private capacity re not capable of making use of their savings for such productie purposes. There should, therefore, be an adequate mechanism

to ensure the flow of such savings to the investors. This necessitates the need of an efficient banking and credit system in the country. In this connection United Nations' experts have observed and suggested that "at present savings often take useless or even harmful forms and that there is need to mobilise them in more suitable forms for use in economic development by furthering appropriate institutions."[1]

Methods of Encouraging Savings in a Developing Economy.

The great importance of savings in a developing economy and its limited scope in underdeveloped countries calls for adopting suitable measures and making serious efforts for the mobilisation of savings there. It might be repeated here that a developing country is concerned only with the economically useful savings or those savings which are obtained for the purpose of economic development. Two fundamental approaches in this direction are possible. Firstly by checking the savings which go into useless or undersirable forms; and secondly ~~be~~ by adopting measures to make positive increases in the volume of savings.

Taking into account the poor use of available savings in underdeveloped countries, a memorandum submitted by the International Bank for Reconstruction and Development has laid more emphasis on the proper use of savings than on their increase. It states that "In low income countries it is difficult to increase the volume of current domestic savings.

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1. United Nations : Methods of Financing Economic Development in Underdeveloped Countries; p. 8

Much can be done, however, to institutionalise savings and encourage its investment in the field of greatest urgency and productivity for the economy".[1]

In order to obtain savings, which are lying in useless forms, to be used for better purposes in the interest of the economy, such measures should be adopted by the Government which do not go against the preference of the ~~waver~~ saver. In a statement, the Director of the Research Department of the International Monetary Fund has expressed that "if savings were to be channelled for purposes of the greatest social value, the public must be re-educated to hold savings assets that were associated with desired types of investment. That, however, was not enough; a re-education along such lines was a slow process. An attempt must be made to give the public, savings -assets somewhat similar to the type of saving assets for which they now showed a preference. For example, mortgage bonds might be issued on state enterprises; industrial banks could issue certificates secured by mortgages on industrial properties."[2] Similarly United Nations' experts are of the view that "in countries where the hoarding of gold is a problem, money could be obtained by governments for purposes of economic development by the issue of gold certificates; where real estate speculation is a problem, mortgage certificates for particular projects could be issued."[3]

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1. United Nations : Methods of Financing Economic Development in Underdeveloped Countries; p. 92.
2. Ibid; p. 147.
3. United Nations : Methods of Financing Economic Development in Underdeveloped Countries; p. 8.

The experts observed that "one of the principal prob- ems is that of overcoming long established preferences for nvestments of particular types irrespective of their profit rospects. Particular attention was called to the tradition n many countries of this region of investing in land and other ypes of real estate as a means of establishing prestige in e community."[1]

To check this, a change in the mode of thinking of hese people is required which can only be brought about very lowly. But to discourage such practices, taxes might be mposed on uneconomic possessions of land, real estates and ther articles so as to make them costly enough, beyond the nvestment reach of individuals. Increased use of capital gains ax has also been suggested to discourage such holdings. In his way individual investments going into such directions might e claimed by Government for better use.

Next comes the importance of adopting measures to ake positive additions in the volume of savings of the under- eveloped countries. It is well known that the rate of saving n underdeveloped countries is, generally, very low; even below % of their national incomes, and this must increase.

Various International agencies[2], who submitted their iews to United Nations, Department of Economic Affairs, re- arding the methods of financing economic development in under- eveloped countries, have recommended that "however low the nitial volume of possible voluntary domestic savings may be,

. United Nations : Mobilisation of Domestic Capital; p. 11.

. Food & Agricultural Organisation : The International Bank for Reconstruction and Development, the International Monetary Fund, International Labour Organisation, the Sub-Commission on Economic Development etc.

t should be one of the objectives of financial policy in onnection with economic development to convert development nto a cumulative and self generating process by "ploughing ack" increases in income - individual, co-operative or public - nto further development."[1]

Among the measures that can be adopted to increase ne volume of savings in an underdeveloped economy, two broad ategories can be formed. First consists of obtaining forced avings, that is by taxes etc. This category has already been iscussed in the foregoing pages. Therefore, present attention ill be paid to the second category, where methods are adopted o induce voluntary savings by individuals.

An atmosphere, congenial to savings might be brought bout by gradually bridging the wide gap between the standards f living of the poor and the rich. This, ~~is~~ to a great extent, an reduce the additional consumption demands of poor people ho comprise the majority of the population. This might be estated here that the demand for consumption is a serious bstacle that confronts the increase of savings in a community.

Again, to encourage savings by individuals and obtain hem for investment into productive directions, Government can ntroduce savings bonds and their sale can fetch individual avings for investment purposes by the Government. Reports nd Documents submitted by the First Working Party of Experts ppointed by the United Nations Economic Commission for Asia nd the Far East, have suggested that for a successful programme f bond sales two fundamental pre-requisites are necessary -

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1. United Nations; Methods of Financing Economic Development in Underdeveloped Countries; pp. 6-7.

rstly, public should have belief in the credit worthiness of e government and, therefore, the credit standing of the Govern- nt bonds. Secondly such bonds should bear interest sufficient attract public savings and divert those funds from going into ss worthy investments.[1] It has also been pointed out that ople should also have the belief that their investment in bonds ll fetch them reasonable return, and not that they would be osers on account of rising prices as a result of inflation.

To popularise savings bonds scheme, Government should ve an efficient machinery to foster their sales. Agencies r the sale of bonds should be easily approachable by common ople. The system of obtaining bonds and encashing them should simple. Simpler and easily approachable system is bound to ve a favourable effect on investors.

Types of bonds are also liable to have sufficient effect ~~fect~~ on the sale of bonds. Bonds should be made available different denominations and having different maturity periods that individuals with different investing capacities may make e of them.

Educational standard of people is also an important ctor in this respect. If people be educated, they will be le to judge the importance of savings in their own life, as ll as in the life of the nation. Thus, Government should so take steps to spread education among masses.

It has been noticed that on account of the lack of ucation, existence of a vast non-monetised sector, inadequate vings institutions and several other traditional factors,

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. United Nations : Mobilisation of Domestic Capital; p. 10.

ural areas of underdeveloped countries contribute very little no amount towards the savings programmes. But Ragnar Nurkse s of the view that large saving potential exists in the rural reas. He is of the opinion that savings potential is concealed n the disguised unemployment, which is a common feature of nderdeveloped countries. There is tremendous waste of labour nd he points out that labour is a source of wealth. He says hat "even with unchanged techniques of agriculture, a large art of the population engaged in agriculture could be removed ithout reducing agricultural output . . . . . The same farm utput could be got with a smaller labour force."[1]

Further he adds that "On close examination we find hat the state of disguised unemployment implies, at least to ome extent, a disguised saving potential as well."[2] He explains t by arguing that in fact only a smaller labour force is equired to work in the field but due to disguised unemployment ore labourers work on that very field without affecting the utput. To this additional labour, he calls the 'unproductive abour' and to the former, he calls the 'productive labour' . e believes that productive labourers are performing 'virtual' aving, they produce more than what they consume. But their avings are offset by the consumption of the unproductive labour. e suggests that if the additional unproductive labour be ithdrawn from the agricultural sector and employed to work on apital projects, rural saving can be increased. But though uite sound, this is necessarily a long process. This method s available only during the later stages of development when

. Ragnar Nurkse : Problems of Capital Formation in Underdeveloped Countries, p. 32.

. Ibid : p. 37.

ie economy has already formed few capital projects, by making se of its savings, and is in a position to employ the excess gricultural labour to work on them.

In the begining period of economic development savings an be mobilised in rural areas by better organisational and nstitutional measures; by better compaign into villages along ith the cooperative and the community development programmes.

United Nations' experts have attached great importance owards the desirability of improving postal facilities in rural reas, for the mobilisation of savings there. The working party f the E.C.A.F.E. experts have recommended, in short, following easures for mobilising savings, especially in rural areas[1] -

1. Life Insurance, compulsory national provident fund chemes, and building and loan societies should be promoted.

2. The efficiency of post offices can be improved by hanges in their organisation, personnel, methods of working, ncentives for postal staff, and by the extension of postal acilities.

3. The countries of the region might investigate hether any advantage could be gained by starting small loan anks as an interim measure preliminary to well-managed co-peratives.

4. Savings could be promoted through cooperatives, ncluding the development of multipurpose societies, the stablishment of strong apex institutions and trained courses or cooperative managers.

. United Nations : E.C.A.F.E.; Mobilisation of Domestic Capital, p. 19.

An atmosphere, favourable to encourage savings can be brought about by taking measures for the prevention of crop damage, wastage, of stored stocks, increasing agricultural productivity, providing supplementary occupations through the expansion of cottage industries and thus, increasing personal incomes and increasing their propensity to save.

It has been noticed that in most of the underdeveloped countries, the section of rural population who can save money, take up money lending as business and charge very high rates of interest. Poor peasants who borrow, are, in turn, deprived of their saving capacity, howsoever little it might be, because they have to pay high interests. This practice detains considerable savings potential of rural areas into useless channels. To do away with it, establishment of small loan banks in villages, have been proposed. Such banks, besides providing useful credit facilities, can also serve to popularise and mobilise savings in rural areas.

Next, cooperatives can play a very important part in mobilising rural savings. Though, it has been noticed that cooperatives have not been successful in most of the underdeveloped countries including India, for various reasons relating to illiteracy, poverty and other backward habits, yet with the development of cooperative institutions savings can be attracted. The working party of E.C.A.F.E. experts have suggested following measures in this connection :-

1. Development of multipurpose cooperative societies;

2. Device to attract the relatively well-to-do farmers to the cooperative movement;

3. Establishment of strong apex institutions;

abilities of societies;

5. Adequate interest rates on deposits;

6. Training course for cooperative managers; and

7. Educational and propaganda campaigns.

Savings campaign should be popularised and implemented rough decentralised agencies and there should be various nds for attracting savings so that it might get the support d participation of most of the people of different capacities.

rket Loans.

It has already been mentioned that receipts under the ad 'Market Loans' comes from the investors who already have high proponsity to save. Raising loans under this head only ounts to a transfer of resources from the private sector to e public sector.

In a mixed economy like that of India it, therefore, ecomes necessary to make sure that such a transfer does not ad to paralise the activities of the private sector. The vestment in the private sector should also rise at the desired te. Under these circumstances market loans should be raised finance the public expenditure only to the extent that do t hamper the activities of the private sector. It should so be productively used. The magnitude has consequently to decided by the trial and error method.

CHAPTER IV

EXTERNAL SOURCES OF FINANCE

The Need

It needs no special mention that the financial requirements of a developing underdeveloped economy are of a very high order - far beyond the capacity of the country to meet internally. The existing capacity of an underdeveloped country is generally very low and it is neither practicable nor advisable to raise it suddently. Besides, the capital - in form of machines, plants, scientific and technical equipments, trained personnel etc. - required for carrying out the development plans is neither present in the economy nor it can be met internally. For such requirements, imports are the only means. Thus, increased imports are almost indispensable for the economic development of an underdeveloped country.

Now, this gives rise to the problem of repayments. An underdeveloped country cannot, with the increase of imports, manage to increase the volume of its exports. A rise in the volume of exports can, possibly, take place gradually over a long period but that too will be conditioned by the trends of the international market. Consequently, the deficit on account of country's balance of payments can be filled if the imports do not carry the immediate burden of repayments. In other words, if the imports are received in the form of loans or grants.

It is sometimes pleaded that the schemes of financing

and mobilisation of country's domestic resources and hence, the role of foreign finance can only be of a subordinate character. But at the same time it cannot be denied that external resources are a 'must' to supplement the domestic resources. Thus, the value of the inflow of foreign savings is that it provides underdeveloped countries with additional resources for development and when received in the form of a grant or a loan, helps to cover the country's balance of payments deficit.

There are only two alternatives to foreign assistance. They are - first, extra hardship on the people of the country and second, a slowing down of the rate of economic development. But, none of these two can be accepted if a country wants to develop its economy at a reasonable rate. The first of the two alternatives, that is extra hardship on the people, will not only destroy their incentives and severe their faith in the government but also reduce their capacity to pay taxes in future. The policy will, thus, prove self defeating in the long run. The second alternative suggesting the slowing down of development rate is also not advisable. In order to develop an underdeveloped country, at a rate faster than the rate of its population growth, it is necessary to fulfil certain minimum conditions, broadly speaking, of the availability of technical personnel and capital to be used in various fields of research and development. These requirements ultimately reflect in financial terms. It is not possible to try to manage with fewer resources and desire to develop at a slower rate. Food and Agriculture Organisation, in a statement has emphatically mentioned that the "development of an under-

be cut back or deferred at will. On the contrary, economic development is governed by certain economic principles of its own. The statement beautifully explains the importance of a minimum initial speed by adding that, "a rocket or moon-ship must attain a definitely established 'speed of release' before it can escape from the earth's gravitational field and become a free moving astronomical object."[1]

Similarly, there is a minimum speed of development for an underdeveloped economy. It cannot break out the binding forces of its poverty with a lesser speed or rate of development.

It has been accepted that "in underdeveloped countries whose income per capita is lowest .... current domestic savings, even if effectively mobilised and directed to productive investments, is not enough to produce a satisfactory rate of economic development. The addition of outside financial resources may be a necessary and in some instances, a substantial feature of such development, particularly in order to accelerate development .... the addition of foreign capital can be of most benefit when the combined utilisation of domestic and external financial resources result in a high rate of investment."[2]

The policy of supplementing domestic developmental resources by external resources has unanimously been approved.

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1. Statement submitted by the Secretariat of the Food & Agricultural Organisation.
   UNITED NATIONS: Methods of Financing Economic Development in Underdeveloped Countries; p.60.
2. Memorandum on Financing Economic Development: Submitted by the International Bank for Reconstruction and Development.
   UNITED NATIONS: Methods of Financing Economic Development in Underdeveloped Countries; pp.94-95.

Prof. Nurkse, along with many other economists holds that "foreign assistance investment is the redeeming force that has to be invoked to break the (vicious) circle on the supply side of capital formulation in low income countries."[1]

United Nations' experts have suggested that "full advantage should be taken by underdeveloped countries of presently available foreign resources, in order to speed up development and ensure that it will proceed without undue strain on the country's material and human resources."[2]

External loans carry with them the burden of their repayments and also that of the interest. On these grounds this policy may not be approved on grounds of the orthodox 'out of debt out of danger' approach, but with the long term point of view external assistance is necessary as well as beneficial. Prof. Lewis says that "nearly every developed state has had the assistance of foreign finance to supplement its own meagre savings during the early stages of its development." Putting forth the examples of England and the United States he has added that "England borrowed from Holland in the Seventeenth and Eighteenth centuries, and in turn came to lend to almost every other country in the world in the Nineteenth and Twentieth centuries. The United States of America, now the richest country in the world borrowed heavily in the Nineteenth century, and is in turn called upon to become the major lender of the Twentieth."[3]

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1. Ragnar Nurkse: Problems of Capital Formation in Underdeveloped Countries; p-57.
2. UNITED NATIONS: Methods of Financing Economic Development in Underdeveloped Countries; pp.3-4.
3. W.A. Lewis: The Theory of Economic Growth; p.244.

From the international point of view also, the assistance by the rich countries to promote the economic development of the poor countries is of importance. There are countries where production is abundant and it can usefully be utilised if it is given as a loan. Moreover, rich countries can get new markets for many of their products by developing the presently underdeveloped countries. That is why many developed countries are willing to extend assistance for financing the development of underdeveloped countries.

Types Of Foreign Financing And Its Conditions

An underdeveloped country can make use of external finances for its economic development in the following three ways:-

1. By obtaining grants from foreign countries and various international agencies;
2. by raising loans for economic development from foreign countries and various international agencies; and
3. by attracting foreign investment and loans by various foreign business and lending organisations.

The first two of the above mentioned categories are directly concerned with the government activities (public sector). The third one is important as it supplements the developmental activities of public sector, and the Government, with its proper fiscal policies, can do much to make the best use of these sources.

One thing is very important in connection with the efforts to obtain foreign help, whether in the form of a loan or a grant that is, it should come without any political obligation of the assistance extending country. This fact has very correctly and clearly been mentioned in India's First Five Year Plan. It states: "External assistance is acceptable only if it carries with it no condition explicit or implicit, which might affect even remotely the country's ability to take an independent line in international affairs."[1]

Among the three types of foreign assistance mentioned above, each has limitations and advantages of its own. Though, much depends on the availability and the way of using it, yet a careful consideration in respect of their hows, whens and whats, is quite desirable.

Grants

Grant is a type of foreign assistance which does not carry with it the burden of repayment or an interest. It then naturally depends on the free and mere goodwill of the grant extending organisation. And thus, the scope for obtaining grants for economic development of an underdeveloped country, is limited, especially in a case where it does not carry any political obligation also.

Grants have played, and are playing, sufficiently important role in the development work of underdeveloped countries. At present United Kingdom and France are spending much as grants for the development of their dependent colonies.

1. Government of India Planning Commission: The First Five Year Plan: p.26.

Big political powers are also taking much interest in this direction, but as already emphasised, this source should very carefully be accepted especially by a country like India which is pledged to the ideal of neutrality and peaceful coexistence.

Still grants have an advantage of their own. There are certain very important investment requirements like the extention and development in the fields of health, sanitation, education and similar social purposes, which require high investments and are of unproductive nature in themselves. On principle, such projects should not be financed by foreign loans. Again it is not possible to attract foreign, private or entrepreneur investment in these channels because of their high initial costs and low or even uncertain chances of profit. Yet such investments are important for a developing economy and for attracting foreign private investments in various other important fields. Such investments might be financed by obtaining grants from foreign countries or assistance giving international agencies. Naturally, preference in this respect should go to such external grants, as is available from the institutions organised on an international basis.

Loans

As mentioned earlier, the scope for financing economic development by way of floating grants is very limited. A poor country requires very high capital investments for developing and extending its transportation, communication, power, irrigation and land reclamation and various other similar projects. In these fields too, private foreign capital cannot be attracted because the size of investment required by these projects

is very large and chances for direct returns or profits are sufficiently low. Such projects should as far as possible, be financed by obtaining loans.

In this connection the memorandum by the International Bank for Reconstruction and Development reminds that "since the servicing of a foreign loan is a fixed annual burden on the balance of payments, excessive borrowing may be a serious handicap to an underdeveloped country, especially if country's external markets are unstable."[1]

Financing of economic development by obtaining loans from foreign resources is subject to few more considerations. It is possible that an underdeveloped country may, theoritically, require a very high order of foreign assistance but it may obtain only little of it. This is a matter of availability. Secondly, it may get more help than its capacity to utilise during a certain period. Another situation might arise when it is in a position to make use of foreign loans to the extent that it might become difficult for the country to pay it back.

In view of these possibilities an underdeveloped country should take foreign loans only to the extent of its ability to pay back and hence the country should take all care to spend loans, on projects which are expected to yield necessary returns. Secondly, even if more foreign loans are available than the country's present capacity to utilise, it should not be accepted. It should be accepted only to the extent of country's present capacity to utilise.

1. UNITED NATIONS: Methods of Financing Economic Development in Underdeveloped Countries; p.99.

In this context, as pointed by Mr. Eugene Black, it is also to be remembered that "aid from abroad will not achieve much, unless it is allied with effort by the recipient country, unless that country is fairly, honestly and efficiently governed, unless runaway inflation is avoided, unless both wealth and taxation are reasonably equitably distributed, unless economic priorities are observed in drawing up development plans."[1]

Assistance For Specific Projects

Generally the prevailing practice of the aid extending bodies is to channel their loans for financing specific productive projects of underdeveloped countries. This method is sometimes, on grounds of simplicity and having clear-cut relations with the donor bodies, preferred by the aid receiving countries also.

This method has some distinct disadvantages. As a matter of fact, mostly a part of, may be minor, the project can be financed internally and external assistance is required for meeting the remaining requirements only. But when the external assistance is given and received for the project as a whole, internal resources which could have also been used for the project are diverted to less productive purposes. This is against the principle of maximum productive utilisation of domestic resources.

1. Eugene Black: Aid for Developing Countries (Art.) Commerce Annual Number, Dec. '61; p.14.

Secondly, the approach of tying assistance to a specific project apparently means that the assistance has been taken to finance a certain project and not to finance the country's economic development as a whole.

Assistance To Cover Balance Of Payments Deficit

Sometimes assistance is given by foreign governments or international agencies, to cover the foreign exchange requirements of a particular project. This method has the advantage that the country can obtain the imports which are necessary for a certain project without causing strain on its balance of payments position. Together with this the country can meet the remaining requirements of the project internally. But the disadvantage, here, is that if the country is not in a position to meet the requirements internally, things would be difficult.

It then follows that assistance for specific projects should be given where the recipient country cannot meet any substantial part of the project's requirements internally; and it should be given to cover the foreign exchange requirements of the project, where its remaining requirements can be met by the country's resources.

Consumption Loans

As a matter of policy the practice of borrowing should strictly be confined to productive capital goods alone. But it has been observed that occasional draughts, cyclic low agricultural production and the increasing consumption demand on account of growing population has frequently led underdeveloped countries to import food from developed countries. This is

generally justified on grounds that food imports are necessary to maintain and develop the human capital of the country. But at any cost, it seems justified that consumption requirements should be met internally; and even if country has to import food in the beginning, the practice should not continue.

A number of United States bilateral aid programmes have supplied underdeveloped countries not only the capital and technical assistance but also commodities (including food items) the sale of which has provided the recipient country with funds (in local currency) for meeting some of the internally met cost of the projects. On one hand such a practice should be condemned because easy availability of external assistance is liable to lessen the domestic efforts of the aid receiving country; but on the other hand this might be approved in view of an underdeveloped country's extremely low capacity to meet the developmental requirements internally. Nevertheless, this can be said that such assistance should only be accepted when it becomes absolutely necessary and if its terms are 'soft'.

Private Foreign Investment

Economic development of an underdeveloped country requires a country-wide programme of fostering economic activities in all possible spheres of development. A programme of such a diverse nature cannot be taken up by the Government alone, especially in a democratic set up. Some fields of development are left to private entrepreneurs as well. If the sphere of private economic activity be joined by foreign

investors, who are understood to have better production and technical skill and better capacity to invest, the vicious circle of poverty, on the supply side can possibly be broken. It can supplement the low investment capacity of domestic entrepreneurs.

Private investment from foreign countries has one distinct advantage that it combines capital, technological and manageri~~c~~al problems under one experienced unit of control. Besides, foreign investment can be supplemented by domestic capital according to the country's ability to do so.

On the other hand it has been noticed that private investments are made in the food stuff or the raw material exporting industries of the underdeveloped areas. This practice is harmful for an underdeveloped economy. Private investors are guided by their private profit motives because they cannot be supposed to have a charitable outlook for any poor country. Private investments are attracted by markets, and market demand does not lead necessarily to a balanced all-round development.

Thus, in this connection, the aim of the Government of the underdeveloped country should be to attract foreign investment in fields which are related to the country's economic development.

Generally, factors which prove to be obstacles in attracting foreign investment for underdeveloped countries are as follows:

(1) Restriction on investors as regards the transfer of their profits abroad;

(2) Lack of assurance that in case of nationalisation of their business, entrepreneurs will get appropriate compensation;

(3) Double taxation;

(4) Fear of compulsory reinvestment of profits;

(5) Various social, administrative and technical uncertainties.

In this connection the International Bank for Reconstruction and Development has recommended that settlement must be reached by the Governments of the capital importing and capital exporting countries to avoid double taxation. Secondly, private foreign investor must be assured, that he can transfer abroad a reasonable amount of his earnings and that, if his investment is nationalised, he will receive appropriate compensation and be enabled to withdraw it in foreign currency.[1]

The Bank statement has further suggested that the capital importing country should ensure a fair treatment for the foreign investor and at the same time it should safeguard itself against the abuses of foreign investment.

Foregoing arguments make it sufficiently clear that as far as possible loans should be taken for productive purposes. Consumption loans can only be justified if they are absolutely necessary in view of meeting the demand for the essential commodities or for the goods capable of improving the country's human capital. Loans should also be taken, preferably, by the international organisations.

1. UNITED NATIONS: Methods of Financing Economic Development in Underdeveloped Countries; p.98.

Terms Of Aid

Only outright grant or loans repayable in local currencies or long term loans with easy terms of repayment and low rates of interest may appropriately be termed as foreign aid. Short term loans with rigorous repayment conditions or at commercial rates of interest should hardly be catagorised as aid.

In view of the proper utilisation of an external loan, it is necessary that it should suit the requirements of the project for which it is being given. Thus, it is only fair to give a long period of moratorium and a rising schedule of repayments for a project which is expected to go into production after a long time and then the output is to go on rising gradually. In a nutshell the terms of assistance should be 'soft' and not 'hard'.

Finally from the point of view of the underdeveloped countries it is necessary that before receiving an assistance they should make sure that the aid will continue. Development is not a short term process. It has to be planned well in advance and is carried out over a long period of time. It is, therefore, desirable that the conditions anticipated for the plans should continue. Thus, if a country is depending even partly on foreign aid, there should be an assurance of its continuity. If things are not certain neither the planning nor the implementation of development schemes will be effective.

Effective Utilisation

Loans carry in addition to repayments, the burden of interest payment. It seems, therefore, of first importance that they should be utilised in most effective manner. Experts of I.B.R.D. have warned that: "External assistance is useful for development only when it is productively employed; if it is wasted the economic progress of the recipient country instead of being advanced, is retarded by the burden of repayments."[1]

From the very beginning of looking for external assistance, it should be remembered that the loan liability is to be paid back and, therefore, the country should plan to expand its exports. If the receiving country is building up its export capacity and is going to produce goods which will reduce its future import requirements, foreign loans will not be too much of a burden on the country. But, if no such capacity is being created, it would be preferable to receive foreign assistance in form of grants and not as loans.

Mr. Eugene Black has stated, "Money will be wasted if it is put into projects for which there is inadequate justification, which have been badly planned, for which essential ancillary services - or even markets - are lacking, or which demand a standard of educational accomplishment that neither management nor labour force possess". He has further remarked "It is no use building electric power stations, unless they can be provided with regular and adequate supplies of fuel and connected with consumers able and willing to use the

1. UNITED NATIONS: Methods of Financing Economic Development in Underdeveloped Countries; p.91.

capacity of the power plants. It is no use building Universities, if none of the young men and women have been able to obtain Secondary education. It is no use building factories if supplies of raw materials cannot be assured, if workers competent to operate their machines cannot be found, if their products cannot be sold (or profitably used). It is no use sowing expensive seed in unsuitable soil."[1]

Thus, it is necessary that all the projects for which external assistance is sought, should be planned in detail, before the assistance is received. If this is not done, work on the project may stop at any step where even one unforseen difficulty arises. Finally, all administrative delays in implementing and using the assistance must be avoided. Delays in using the assistance will increase the burden of loans and may also give rise to several unforseen troubles.

In short, to a great extent, efficient utilisation of external assistance depends directly on the country's absorptive capacity, which the country itself can develop.

1. Eugene Black: Aid for Developing Countries: (Art) Commerce Annual Number, Dec. '61; p.14.

CHAPTER V

DEFICIT FINANCING

The major limitation on the revenue side in underdeveloped countries are the low average level of per capita income, inadequate taxation of the rich and political and administrative problems encountered in taxing the poor. The deficiencies on revenue side become more pressing in the light of increased developmental expenditure of a very high order. Besides, expenditure also has to grow on account of increase in population urbanisation and the growth of the economy. Along with it social services expected from the governments has also increased. Thus with the changing society and developing economy government expenditure has to grow at a fast rate.

Consequently, deficit financing has to be adopted to cover a substantial part of the government outlays. Government borrowings from the Central Bank and credit expansion by the commercial banks, in turn, exercises an expansionary effect on the money incomes in the economy, and finally the effective demand rises.

Generally speaking the excess of government expenditure over its current receipts is termed 'deficit financing'. This term, in United States and many other countries, is used to mean all expenditures by the government over its current revenue receipts alone. Thus, all expenditures financed by way of borrowings from the public and banks etc., are included in deficit financing. In India, public receipts and expenditures are dealt

ıder two separate heads - the Revenue budget and the Capital ıdget, and the total expenditure by the government in excess ? the receipts under both the budgets is termed to mean deficit inancing. Thus, according to the Indian concept deficit finan- ing is a measure which injects more money into the economy. In ther words, contribution of the government to the increase in he money supply is termed deficit financing.

ethods of financing a deficit

A deficit can be financed by measures which are exclu- led from the Revenue and the Capital budgets of the government. enerally these measures are -

1. Obtaining money from the cash balances of the Government;

2. Borrowings from the Central Bank;

3. Borrowings from the banking system;

4. Issue of additional currency by the government.

In India, the measures of deficit financing do not include the issue of new currency by the government to any substantial extent. Secondly, borrowings by the government from the banking system are accounted in the capital budget and thus, borrowings from banks ceases to be a source by which Government can finance its budgetary deficits. Hence, in India, deficit financing can broadly be defined as the sum of government borrowing from the central bank i.e., the Reserve Bank of India, and the drawing from government cash balances.

In underdeveloped countries, governments have to assume the responsibility of promoting capital formation by taking up projects such as irrigation works, transportation, industries etc.

ch projects, despite being highly productive and indispensable om the social point of view, can not be taken up by private ivestors because the financial requirement required for the im- lementation of such schemes are of a very high order. A subs- antial part of this capital expenditure has to be financed by eans of budget deficits. Deficit financing, in itself is not voluntary choice. It has to be adopted as a last resort when he indispensable financial requirements outgrow the magnitude f resources which are available for financing them.

The use of deficit financing in underdeveloped coun- ries has, never the less, been disapproved by several economists ecause it gives rise to inflation. Though inflation is liable o create certain difficulties, but it is feared that in an ttempt to reduce the inflationary pressure, if the deficits are reduced the resultant decrease in developmental expenditure would retard the growth of production and would make the task of future capital formation all the more difficult.

Inflation and Capital Formulation

It is believed that deficit financing of development expenditure, even if it leads to inflation, would actually bring about more capital accumulation then would otherwise be the case.

It has already been mentioned that the financial re- quirements for the development of an underdeveloped country are of a very high order and despite the social usefulness of the undertaken projects, private entrepreneurs can not be expected to make any substantial contribution. Government has to come forward to shoulder this responsibility. This can not be

one merely by mobilizing the genuine voluntary savings of the eople since in a poor country such savings, wherever possible, re very low and often used in uneconomic forms. Under such ircumstances, when the requirement is not an option, a choice an be made only as regards the manner of raising the resources. his can possibly be done by -

1. Making people work harder and longer with giving hem the benefit of increased income;

2. Taking away a substantial portion of the income of eople by way of high taxation or by obtaining forced loans;

3. Curtailing the private investment programmes and obtaining the resources thus obtained for public investment;

4. Forced saving through inflationary methods of finance.

The first three alternatives can not be depended especially in a democratic set up, beyond certain limits on account of various political and administrative grounds. Sometimes it is argued that when deficit financing also amounts to forced savings particularly through the people belonging to the low income group, why not the indirect taxes be levied on an extensive scale. Their effect will certainly not be very different from that of a rise in price level resulting from inflation. But despite being similar in effect, deficit financing has a definite advantage over indirect taxation. It does not require any administrative skill or special machinery to create inflation, while extensive indirect taxation, besides being opposed, will bring with it a rise in the cost of collection, additional staff, chances of evasion and corruption and many other complications. Similarly

private savings can also not be transferred to public sector excessively. Production of non-capital goods, generally by the private entrepreneurs, is also important as it helps in keeping the domestic inflationary pressure in control.

The foregoing arguments make it sufficiently clear that the desired rate of public investment may not be attained if there is a rigid approach for following the general principle of 'sound financing'. Deficit financing even if it leads to inflation, it is argued, will at least provide finance for the development projects. As the projects are completed, production in the economy will increase and, in future, will enable the people to save more and the government to increase the tax revenue. Thereafter it can be expected that as a result of increased revenues and increased public savings, future development will require less of deficit financing, and the share of deficit financing will go on decreasing. Since inflation will not last very long, it will not destroy the incentives of private individuals altogether.

Another point in favour of deficit financing is that with the implication of development projects, some of the bottlenecks which hamper the production will be eliminated and new investment opportunities will appear. These new opportunities will also help in increasing the saving capacity of the economy.

Besides providing government finance, inflation is also likely to encourage private investment. Increased money incomes are likely to give rise to the demand for goods and commodities, essentials as well as that of comfort. This will enlarge the profit margin of the private investors and this will, in turn,

A short lived inflation would also induce the habit of thrift among the people. The general rise in prices and the reduced real incomes will encourage them to work more to maintain their living standards. This will also be in the interest of the nation; but it should be repeated that for this the inflation should be short lived.

Recommending deficit financing for financing economic development the United Nations experts have said, "In brief, deficit financing may lead to inflation, but at the end of it all we would have the dams and the irrigation canals and the roads which could not have been started in the first place if rigid insistence on the sound financing was maintained. Admittedly, inflation will impose hardships; but this may be inevitable - the real issue is about the means of enforcing sacrifices. Inflation need not have untoward consequences because it need not last long and its adverse effect can be suppressed to some extent."[1]

Objections against Deficit Financing

Though it has been accepted that inflationary methods are almost necessary to supplement the available resources for the economic development of an underdeveloped country, yet it does not follow that the deficit financing of capital expenditure will easily and automatically lead to the required capital formulation. It is just possible that deficit financing has its limit too. Inflation after a certain level, or if it continues for a long time, may start retarding the rate of capital formation in the economy.

Moreover, it is to be noticed that inflationary financing can be used in the interest of capital formulation only under certain conditions. The course, however, the U.N. experts have agreed "has many pitfalls". They further have agreed that - "unless moderately and wisely used may do more harm than good."[1]

The conditions necessary for a beneficial use of deficit financing are generally difficult to maintain with the result that inflationary methods of financing have from time to time been criticised and opposed.

It is argued that as deficit financing, as a measure to enforce sacrifice, is administratively more simple as compared to tax administration, it is liable to encourage extravagance. Government may neglect the fuller use of sources such as small savings and taxation etc.

The second argument against deficit financing is that one can not be sure of the duration and extent of inflation introduced by it. This fact is liable to make its administration difficult.

There is one more presumption that the volume of deficit financing will go on declining and its place will gradually be taken up by the increased private savings and taxes resulting through productive development expenditure by dificit financing. This is also partly true. Firstly, the time taken for the production to increase will not be very short and secondly, a substantial portion of increased income through increased output will also be taken up for increased consumption and increased private

1. UNITED NATIONS: Economic Bulletin for Asia and the Far East: Third Quarter 1951; p.25, Inflation and the Mobilisation of Domestic Capital in Underdeveloped Countries of Asia: Prepared

investment. The rise in government share by tapping out individual savings and increased taxes can not be of a very high order. In underdeveloped countries, increased production can not be expected to be saved. There is a chance that all the increased production is consumed. Inflation, in agrarian economies, generally raises the incomes of either the rich class or of the poor class who have a very high propensity to consume.

The tax system of underdeveloped countries also do not have the natural bouncy. Tax revenues do not automatically rise with the rise in national output. This fact also goes against the expectations for beneficial deficit financing.

It can also not be taken for granted that deficit financing of capital expenditure will necessarily enforce sacrifice on the desirable section of people. The income of poor people might not rise as the prices rise. Moreover, this will mean extra hardship on the people belonging to the class of salary earners. Their incomes will not rise at all as a result of deficit financing but they will have to face the general price rise. The poor class may also find after some time that the rise in their monetary incomes was only illusary.

It is also worth questioning that why deficit financing is used in considerable doses and then governments try to neutralise its effect by granting fresh allowances, price controls, fair price ships, compulsory requisition of food stuffs etc. This all amounts to very little of forced saving and only increases the administrative burden.

Sometimes it is argued that inflation encourages entrepreneural investment by increasing the productivity of

investment. But, at the same time, it is questionable whether such investments are of domestic importance. It can very easily be understood that increased private investment will only go in the non-necessary directions because private entrepreneurs are interested only in their ownership benefits and not in the use benefits. Businessmen will invest in such fields where scope for profit is more, and such fields are generally of little importance to the nation. For this reason inflation is charged for distorting the pattern of production and investment in the economy i.e., inflation is beset with the danger of channelising economic resources into less urgent and speculative fields.

It is also to be remembered that deficit financing along with its inflationary effects might prove beneficial in economies where there is sufficient capital lying unused for want of purchasing power among the public. There, it can set the idle resources to motion. But in an underdeveloped economy, where the increase of purchasing power with the public can not be accompanied by rise in production on account of the shortage of productive capital, it can only result in the rise of prices. In short, in the presence of abundant real capital deficit financing generates investment and employment multipliers and in its absence it generates only the price multiplier.

The final objection is concerned with the cumulative effect of deficit financing. A prolonged inflation may cause severe harm to the economy. As a result of continued rise in the price of commodities the factor costs also start going up; and this makes a cycle. With the result that what may appear to be a mild inflation in the begining will turn into hyper-

That is why specialists have, mostly, warned against the dangers of inflation. E.M. Bernstein and I.G. Patel have expressed; "the over powering strength of the forces let loose by inflation to achieve what in fact is likely to be only a moderate increase in investment (which could have been achieved in larger part, if not entirely, by less aggressive means) ultimately converts continuous inflation into a destructive policy. A large part of any increase in investment will take forms that are of negligible importance in increasing agricultural or industrial production. The economy is distorted by the inflation so that its use of productive resources is less effective than it would otherwise be. And the effects of the inflation on the distribution of income and wealth are unhealthy and may be dangerous in countries with low incomes."[1]

United Nations' experts have also pointed out: "It is generally overlooked that, to the extent that deficit financing results in an inflationary rise in domestic prices, it is no less aggressive than taxes which hurt the poor relatively more than the rich. The decision not to levy higher taxes in general or taxes on the poor in particular, in favour of larger budget deficits may have been merely an economic mistake or a political compromise."[2]

<u>Non-inflationary deficit financing</u>

Though inflation is the outcome of deficit financing yet all deficit financing need not be inflationary. There are certain factors which automatically appear in a developing economy and necessitate an increase in money supply in the economy.

n the first place increased production of goods in the economy s a result of economic growth is bound to give rise to the de-and of increased money supply for transaction purposes. This emand can be met by injecting more money in the economy through eficit financing.

Secondly, economic development is expected to be accompanied by expansion in the monetised sector. In under-leveloped countries there is a vast sector which lives on sub-sistence farming and something like a barter system prevails there. Economic development is expected to bring more earnings to this sector and will thus necessitate the use of money in this sector also. This factor will also increase the demand for money.

Thirdly, increased imports, which are so very essen-tial for economic development, will amount to increase in real wealth in the economy and thus there will be a need for an equivalent rise in money supply.

Lastly, liquidity preference, how-so-ever discouraged in backward and underdeveloped countries, is bound to continue for some time. The habit of cash hoarding will go only slowly. An increase in economy's money supply will offset those hoard-ings.

Factors mentioned above create a demand for increasing money in the economy and thus deficit financing to that extent seems only to fulfil this natural demand without producing any inflationary effect on the economy. But on the other hand there are certain other important factors to be remembered which also appear in a developing economy and are inflationary in nature.

hey limit the scope for adopting measures for deficit financing n the economy. Firstly, it is expected that the incomes of the eople of lower class will rise. Employment opportunities will xpand and many more people, who were previously poor, will have ew and increased incomes. Increased income of the poor people, who are in a great majority, will give rise to the demand of consumption goods and tend to create inflationary pressure on he economy. This factor is all the more effective in countries where redistributive measures are being adopted as a result of country's socialistic policies.

In countries where banks are not nationalised, they provide the second factor in limiting the scope of deficit financing by the government. Private banks take substantial part in financing the private sector and thus expanding the money supply independently.

Thirdly, in a developing economy the velocity of money increases. This factor is also inflationary in character. Thus, while there are factors which make a case for deficit financing during the period of economic development of an underdeveloped country, there are also the above mentioned factors which limit its scope.

Deficit Financing for Economic Development

The technique of deficit financing may be adopted, broadly under two circumstances. Firstly, in case of a temporary budgetary gap and secondly, in case of a developing economy to supplement the available resources for development till the economy reaches a stage of self propelling and self generating economic growth.

So far as the first condition is concerned, deficit financing can hardly be justified. One of the foremost principles of public finance suggests to aim at a balanced budget and thus, forbids its use, especially when it is to be used as a temporary measure to bridge the gap of resources under normal circumstances. In the words of United Nations' experts: "It is generally considered undesirable under normal conditions to depend on budget deficits for current consumption expenditure of the government."[1]

Next comes the role of deficit financing in order to supplement the resources of a developing economy. This role, though it drew great controversy, has been accepted by the experts of the subject. The United Nations' experts, while agreeing that "inflation, once started, can easily get out of control and be accompanied by disturbances of various kinds,"[2] have also pointed out that, "within bounds, inflation is itself an acceptable pragmatic instrument of a developmental policy."[3]

The greatest advantage of deficit financing in a developing economy is that it provides the government an additional financial power, which is indispensable in view of country's limited capacity to save and the pressing need for developing the economy at a fast rate. Now, the problem remains in guarding against its evil after effects which lie mainly in its excessive and continuous use. It is true that deficit financing leads to inflation but that too, within reasonable limits, can be used to produce favourable results.

1. Economic Bulletin for Asia & the Far East, Nov. 1954, p.7.
2. Economic Bulletin for Asia & the Far East, May. 1955, p.13.
3. Taxes & the Fiscal Policy in Underdeveloped Countries, p.8.

One major condition for obtaining favourable results from deficit financing is that output should rise in the following years. The increased output is supposed to take care of the increased effective demand resulting from deficit financing. To fulfil this condition it is necessary that the created money should be spent on quick yielding projects in the begining. If this is done, the inflationary pressure, after a brief time lag will be off set by increased production.

Some economists are of the view that the apprehensions with regard to the adverse effects of deficit financing have been unduly exaggerated. In their opinion "deficit financing is a necessary and a positive instrument to accelerate the rate of economic growth in countries suffering from acute shortage of capital, though it is necessary to emphasise it here that it must be undertaken in context of an efficient and well executed plan of economic development."[1]

Inflationary effects of deficit financing can also be used for favourable results. Inflation, in the begining, as already mentioned, encourages investment. Besides, Dr. V.K.R.V. Rao has suggested the scope for increased taxation by the government, under such circumstances.[2]

Professor W.A. Lewis has suggested that if prices are rising at a rate less than the rate of interest, there is no profit in speculation. Hence, if prices rise on the average by 3 to 4 percent per annum, we can have all the benefits of inflation for capital formulation without much danger that this will give rise to speculative boom and to a flight from currency

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1. R.N. Tripathi: Federal Finance in a Developing Economy; p.151.
[illegible] Capital Formation and Price Behaviour in [illegible]

especially if the movement is punctuated every three or four years by a little deflationary prices.[1]

In the light of the foregoing discussion it can be said that inflation, to a certain degree, can remain harmless, within control, or even beneficial. Its optimum limit will be at the level where marginal increase in the cost of living and industrial output are equal.

It can be concluded with the firm belief of Dr. V.K.R.V. Rao that "deficit financing in itself is neither good or bad; it all depends upon the circumstances in which it is resorted to and the economic policy which is followed to neutralise its adverse consequences. In fact a certain measure of deficit financing is inevitable under planned economic development, especially when one of the objectives of planning is to step up the tempo of economic progress beyond what it would have been in the absence of planning."[2]

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1. W.A. Lewis: The Theory of Economic Growth; p.404.
2. V.K.R.V. Rao: Deficit Financing & the Five Year Plan; Commerce Annual Number, Dec. '52, p.60.

PART II

(Financing of development expenditure in India)

CHAPTER VI

OUTLAY OF THE FIRST FIVE YEAR PLAN

The Plan

India stepped out towards planned development with the begining of the First Five Year Plan. The Plan initially aimed at an outlay of Rs.2,069 crores, for strengthening and development of India's national economy, by the public sector over a period of five years i.e. 1951-56.

This total sum of expenditure was distributed under different heads of development as given below:-

	Total allocation. Rs. Crores.	Percent of the total
1. Agriculture and community development	361	17.5
2. Irrigation	168	8.1
3. Multipurpose irrigation and power projects.	266	12.9
4. Power	127	6.10
5. Transport and communication	497	24.0
6. Industry	173	8.4
7. Social services	340	16.4
8. Rehabilitation	85	4.1
9. Miscellaneous	52	2.5
	2,069	100.0

The First Five Year Plan, as also the above mentioned pattern of allocation serves to show, laid greatest emphasis on the need for agricultural development. It can be seen that Rs.922 crores were allotted for Agricultural and community development along with its allied needs of building and expanding irrigation projects and the generation of power etc. This was well over

44.5% of the total outlay on plan.

Comparatively lesser sum was allotted for industries. It was said that "the expansion of industries during 1951-56 will mainly depend on private initiative and resources, but will be supplemented by the resources of the publis sector, as well as by foreign investment at certain points."[1]

It was expected that the total outlay of Rs.2,069 crores by the public authorities will increase the productive equipment in the private and public sector to the extent as mentioned below:

1. Outlay which will add to the stock of productive capital owned by Central and State Governments.	Rs.1,199 crores
2. Outlay which will contribute to building up productive capital in the private sector.	Rs. 396 crores
3. Outlay on social capital	Rs. 425 crores
4. Outlay unclassified above	Rs. 49 crores
Total	Rs.2,069 crores

The above classification shows that nearly 60% of the total outlay was expected to add directly to the productive capital, in the ownership of Central or State Governments, mainly under irrigation and power, transport and communication and industries.

Remaining 40% was partly to add to the productive equipment in the private sector and partly to provide assistance, in the form of working capital or of advisory and administrative services for the maintenance and expansion of social services. Besides, it was thought that this will act as an incentive for community effort in development.

1. The First Five Year Plan: Page 71.

The total developmental expenditure totalling Rs.2,069 crores was to be financed out of the resources of the Central and State Governments in the following order:-

Central Government		Rs.1,233.7 crores
Andaman and N.E.F.A.		Rs. 7.0 "
States -	Part A	Rs. 610.0 "
	Part B	Rs. 173.0 "
	Part C	Rs. 32.0 "
Jammu and Kashmir		Rs. 13.0 "
	Total	Rs.2,068.7 crores

Thus, nearly 60% of the total outlay on the First Five Year Plan was to be met through the resources of the Central Government.

Later some additions were made in the programmes which necessitated some readjustments in the Plan. Consequently the total outlay by the public authorities on the plan was raised to Rs.2,377.7 crores. With this new total outlay, expenditure on different heads were revised and fixed as following -

	Rs. Crores	
	Original allocations.	Revised allocations.
1. Agriculture and community development	361	354
2. Irrigation, Multipurpose and Power projects	561	647.4
3. Transport and communications	498.5	570.0
4. Industries	173.0	188.0
5. Rehabilitation	85.0	135.7
6. Social services and Miscellaneous	390.2	482.6
Total	2068.7	2377.7

New allocations introduced slight shortcuts in the utlays on agriculture, community development, irrigation and ower projects etc., while it provided more for other heads ~~hands~~ of evelopment.

<u>esources</u>.

Looking towards the resources of the Central and State Governments, it was found that approximately Rs.1,414 crores only could be made available towards the requirements of the plan.

	Central Govt. (+) Andaman & N.E.F.A.	States	Total
	Rs. Crores		
Planned outlay on development	1741	328	2069
1. Budgetary resources			
a. Savings from current revenue	330	408	738
b. Capital receipts	396	124	520
c. Inter Government transfer	-229	229	-
2. External resources already received	156	-	156
Total	653	761	1414

Thus a gap of Rs.2,069 crores minus Rs.1,414 crores, i.e. Rs.655 crores was left to be covered. This gap was to be covered as much as possible by (1) External assistance (2) Internal additional taxations and borrowings and as little as possible by deficit financing.

Annual outlay on the plan for years 1951-52, 52-53, and 53-54 were proposed to be Rs.232 crores, Rs.346 cpores and Rs.400 crores respectively.

It was further said that if the expected foreign help could not be made available till then, future estimates will have to be adjusted.

Growth of Expenditure

Review of the First Five Year Plan disclosed that the aggregate outlay on the Plan by the public sector was about Rs.1,960 crores.

The distribution of the outlay between the Centre and the States, year by year was as follows[1]-

Rupees Crores

	Year	Outlay on plan by Centre.	Outlay on plan by States.	Total
Accounts	1951-52	132.1	127.3	259.4
"	1952-53	125.4	142.2	267.6
"	1953-54	181.3	161.7	343.0
"	1954-55	283.6	192.3	475.9
1951-55	(Total for 4 yrs)	722.4	623.5	1345.9
R.E.	1955-56	392.5	274.0	666.5
Total	1951-56	1114.9	897.5	2012.4

As given in the above table, it was estimated that the outlay in the fifth year will be Rs.666.5 crores. But later estimates revealed that, it was about Rs.52 crores less than the originally estimated level. This difference between the expected outlay and the estimated actual outlay accounts for the deviation of the total, from the corresponding figure shown in the above table.

Thus the original, revised and the actual outlays on the First Five Year Plan were Rs.2,069 crores, Rs.2,377.7 crores and Rs.1960 crores respectively. These were distributed among the centre and the states as shown below:-

1. Review of the First Five Year Plan, Page 13.

	Plan Outlay		Rs. Crores
	Original	Revised	Approximately actual
Centre	1233.7	1389.5	1114.9
States	835.0	988.2	897.5
Total	2068.7	2377.7	2012.4

The table of annual outlay on plan shows that the plan began with very low expenditures. Step up in expenditure, both at the Centre and the States, over the period of the plan was considerably high. The expenditure during the last year was nearly thrice by Centre and nearly twice by the States as compared to their respective expenditures during the first year.

It is also notable that nearly 57% of the total expenditure made on the plan accounted for last two years, 1954-55 and 1955-56.

Original, Revised and the Actual Outlays compared.

The following table gives a comparative detail of the expenditure made during the plan and its original and revised targets under major development heads:

	Plan Provisions		Rs. Crores Estimated plan outlay 1951-56.
	Original	Revised	
1. Agriculture and community development.	361	354	284.2
2. Irrigation and Power	561	647.4	585.0
3. Industries	173	188	99.8
4. Transport and Communication	498.5	570	531.5
5. Social Services. (including Misc.)	475.2	613.3	511.9

The above table shows that there has been shortfall under every head.

The following table compares the pattern of outlay as it actually materialised over the Plan period with pattern that was in view when the plan was initially formulated:

	Percentage of total outlay as originally proposed.	Percentage of total outlay as now estimated.
1. Agriculture and community development	16	14
2. Irrigation and power	28	29
3. Industries	8	5
4. Transport and communications	24	26
5. Social services (including Miscellaneous)	24	26
Total	100	100

This shows that the pattern of the outlay on First Five Year Plan, as it materialised, was to a fair extent similar to that it was proposed, leaving the case of industries which show a shortfall of nearly 37%.

Investment and the Current Expenditure.

It is estimated that ratio of the investment and current expenditure, out of the aggregate outlay on the plan has been about 3 to 1.

"The aggregate expenditure on capital account corresponding to the total outlay of Rs.2,012 crores amounts to Rs.1,470 crores, the balance namely Rs.542 crores being expenditure on revenue account. Part of this later has been of the nature of investment, so that on the whole if aggregate expenditure on the plan is taken at Rs.1,960 crores as suggested earlier, the

total of investment in the public sector would work out round Rs.1,500 crores"[1].

Besides, it is estimated that the amount of investment in private sector, over the plan period was about Rs.1,600 crores.

This gives that the total investment in economy during 1951-56 was about Rs.3,100 crores.

Expenditure by the Centre and the States.

The following table gives the targets of expenditures and the expenditures which were actually made, by the Centre and different states over the five year plan period:

Rupees Crores

	1951-56 proposed	1951-56 actuals	Expenditure incurred as percentage of the target.
Centre	1389.5	1114.9	80.2
States	938.2	397.5	90.8
Part A States:			
Assam	21.7	21	96.8
Andhra and Madras	157.3	149.8	95.2
Bihar	68.7	73.2	106.5
Bombay	159.9	156.2	97.8
Madhya Pradesh	48.2	42.5	88.2
Orrissa	21.2	18.3	86.3
Punjab	34.4	31.8	92.4
Uttar Pradesh	129.8	105.5	81.3
West Bengal	76.5	74.6	97.5

1. The Review of the First Five Year Plan: Page 21.

Rupees Crores

	1951-56 proposed	1951-56 actuals	Expenditure incurred as percentage of the target
Part B States:			
Hyderabad	47	34.4	73.2
Madhya Bharat	22.6	21.3	94.2
Mysore	49.7	43.1	86.7
Pepsu	10.1	9.9	97.1
Rajasthan	25.5	20.3	79.6
Saurashtra	27.2	25.8	94.9
Travancore-Cochin	31.3	26.1	83.3
Jammu and Kashmir	12.7	11.1	87.4
States C and D	44.3	32.6	73.6
Total (Centre & States	2377.7	2012.4	84.6

CHAPTER VII

RESOURCES FOR THE FIRST FIVE YEAR PLAN

Financing the Plan.

The plan as initially formulated, involved an outlay of Rs.2069 crores, by the Centre and States over the five year period. Later, in view of certain requirements, stepping up of the aggregate outlay from this level was deemed to be necessary. Consequently the adjustments raised the size of the Plan to Rs.2378 crores.

Early calculations suggested that a sum of Rs.1414 crores could be raised by way of proceeds from revenue and the capital receipts including all loans, grants and aids etc. (Domestic resources Rs.1258 crores, Foreign aid Rs.156 crores).

The remaining sum of Rs.655 crores was to be raised by taking resort to additional taxations, by seeking more foreign help, by more of borrowings from the public or as a last resort by deficit financing.

At the same time, it was also recognised that unless special circumstances arose, deficit financing should not exceed Rs.290 crores.

Thus, in short, the sum of Rs.2069 crores (according to original estimates) was to be raised in following order:

1. Through domestic resources by way of taxes, loans, small savings etc.	Rs.1258 crores
2. Foreign aid:	
(a) already in sight	Rs 156 "
(b) needed more	Rs 365 "
3. Deficit financing	Rs 290 "
Total	Rs. 2069 Crores

Outlays, during the first four years of the Plan on the basis of accounts for those years and the financial resources, of the Centre and the States combined, were as follows:[1]

Rs.crores

	Years	Outlay on plan	Budgetary resources	External assistance	Deficit
	1951-52	259.4	204.3	64.9	-10.3
	52-53	267.6	141.3	45.6	80.7
	53-54	343.0	246.1	13.5	73.4
	54-55	475.9	368.6	16.0	91.3
Total	51-55	1345.9	960.3	145.0	240.1

On the basis of accounts for the first four years and revised estimates for the fifth year, it was calculated that Rs.2012.4 crores were spent on the Plan. But later estimates revealed that the actual expenditure on the Plan was of the order of Rs.1960 crores, against the original target of Rs.2069 crores and the revised and enlarged target of Rs.2377.7 crores.

The expenditure on the First Five Year Plan was financed as given below:

1. Resources made available out of revenue account (inclusive of Railway's contribution)	Rs.	752	crores
2. Loans from the public	Rs	205	"
3. Small Savings & unfunded debts	Rs	304	"
4. Other miscellaneous receipts on capital account	Rs	91	"
Total of Domestic Budgetary resources	Rs	1352	"
5. External Assistance		183	"
6. Resources raised through deficit financing	Rs	420	"
Total	Rs.	1960	Crores

1. Review of First Five Year Plan: Page 23.

Thus, in the light of figures given above, the nearest data for the actuals of outlay on plan and its financial resources during the fifth and the last year, we get -

1. Outlay on Plan during 1955-56	Rs. 614.1	crores
2. Sum raised through budgetary resources	Rs 391.2	"
3. External assistance	Rs 43.0	"
4. Deficit financing	Rs 179.9	"

It is also desirable to examine, that how far the actual outlay over the plan, could reach the targets set for them. The table below gives a comparative picture of the two:

Rs. Crores

	Plan target 1951-56 Original	Revised	Plan outlay Actual
Outlay on the Plan	2069.0	2377.7	1960.0
Budgetary resources	1258.0	---	1352.0
External assistance	521.0	---	138.0
Deficit	290.0	---	420.0

Thus, it appears that the budgetary resources crossed the initially expected figures. The shortfall of about Rs.109 crores in the expenditure, it may be said, occured due to the shortfall in the external assistance, which came out to be much below the expected figures. This very reason might be put, as an explanation for the increase in deficit financing. Though it was very clearly mentioned in the First Five Year Plan that deficit financing should not exceed Rs.290 crores.[1]

It is true that while comparing the target and the actual resource figures, the shortfall is noticed only against the external assistance column, yet there is one more fact to be remembered that

/ 1. The First Five Year Plan: Page 46.

at the time when the Plan was formulated, an external assistance of only Rs.156 crores could be foreseen. The remaining sum alloted to be raised through more external assistance, i.e. Rs.365 crores, as a matter of fact represented the gap in resources. This was to be raised either by seeking more of foreign help or by the internal budgetary resources.

Latest figures[1] reveal that Rs.296.33 crores were actually available as loans and grants from foreign countries, to be used for financing the Plan, but only Rs.188.11 crores could be utilised. Though, certain reasons have been given for the inability of utilising the foreign resources to the extent it was available, but it is clear that even if more external help could be sought, the total outlay on the plan would not have changed.

Raising of resources by the Central Government

Review of the First Five Year Plan gives that a sum of Rs.1465 crores, was raised by the Central Government towards the financing of the Plan expenditure. Item wise break up of the sum was as follows[2] -

1. Through revenue surplus and the railway earnings.	Rs.	420	crores
2. Loans, small savings and other capital receipts.	Rs.	558	"
(1) + (2) Budgetary resources.	Rs	778	"
3. Foreign aid.	Rs	203	"
4. Deficit financing.	Rs	484	"
Total of Central Government resources.	Rs	1465	"

Thus, the resources of the Central Government were responsible for financing about Rs.1465 crores out of the Plan requirements.

1. Review of the First Five Year Plan; Page 30.
2. Figures are based on the accounts for the first four years and revised estimates for the last year of the Plan.

Rs.484 crores, given for deficit financing by the Centre responds to the yearly deficits as follows.

Years.	Deficits at the Centre.
1951-52	Rs. -(55.3) crores i.e.a surplus
52-53	Rs. 30.9 crores
53-54	Rs 127.2 "
54-55	Rs 145.4 "
55-56 (Revised estimates)	Rs 235.6 "
1951-56 Total	Rs.433.8 crores

But, the latest estimates show that the figures, given for the total Plan outlay, total deficit financing and total external assistance utilised were all lesser, when seen in the light of the (probable) actuals for the year 1955-56, than what the corresponding figures given on the basis of revised estimates for that year. This difference makes (1) the total deficit financing by the Central Government to be of the order of Rs.428 crores only.[1] (2) This also suggests that deficit financing at the Centre during 1955-56 was of the order of only Rs.130 crores and not Rs.235.6 crores as given by revised estimates. (3) External Assistance utilised during the Plan was of the order of Rs.188 crores and not Rs.203 crores as given above. These adjustments bring the total outlay by the Centre in 1955-56 to Rs.321.9 crores and outlay on the Plan by the Centre over the five year period comes around Rs.1044 crores only.

In this light, resources of the Central Government can be summarised as given below -

1. Deficit at Centre during the first four years came around Rs.248 crores. Deficit financing by States during the last year, according to the Review, was negligible and the aggre-

Total resources of the Central Government (internal)	Rs.778 crores.
Transfer to the States.	Rs 350 "
	Rs.428 crores
Foreign aid utilised.	Rs 188 "
Deficit financing by the Centre.	Rs. 428 "
Total	Rs.1044 crores.

States

In the states, the total outlay[1] of Rs.897 crores was financed as follows -

	Rs. Crores.	Percentage of the total -1 (app).
1. Current Revenues.	269	30%
2. Public Borrowings & other Capital receipts.	230	26%
3. Central Assistance.	350	39%
4. Deficit financing.	48	5%
Total	897	100

Here, it may again be noted that the States' share in financing the (revised) First Plan, according to initial estimates was Rs.988.2 crores.[2]

Budgetary resources

According to the initially formulated Plan, it was estimated that a sum of Rs.1258 crores was to be raised through budgetary resources. Out of this sum, Rs.740 crores i.e. 58% of the total budgetary resources, were to be raised by way of contributions from current revenues including additional measures of taxation, and the receipts from the Railways. But, the actual yield through these resources, over the five year period was estimated

1. Review of the First Five Year Plan, Government of India, Planning Commission; Page 24.
2. Review of the First Five Year Plan: Page 45.

to be Rs.690[1] crores only (Rs.574.3 crores from current revenues and Rs.115.4 crores from Railways).

As regards the yields from the States' and the Central Government's current revenue budgets, Centre was able to raise Rs.145 crores more than the Plan targets required, while there was almost an equal short fall in the States.

Thus, the Centre and the States raised almost the amount what they aimed to raise. The balance shortfall of nearly Rs.48 crores was mainly due to lower earnings of Railway, than what it was expected.

<u>Additional taxation</u>

<u>Centre</u>

The Central Government imposed dubstantial taxation in 1951-52 partly for the reason to raise the amount needed to finance the development but mainly in order to generate a disinflationary climate.

Rise in taxation during 1951-52, was mainly through rise in -

1. Export duties - Export duties, which had been raised in 1950-51, were raised further on a number of commodities, in order to draw into public exchequer, proportion of the increase in incomes being made in the export sector.

2. A surcharge on income tax - Besides the usual income tax, a surcharge on income tax was charged by the high income groups.

3. Increase in the corporation tax.

4. Additional excise duties and import duties.

These measures of additional taxation, implemented during 1951-52, produced a total yield of Rs.32.0 crores. It was also

1 Review of the First Five Year Plan; Page 39.

notable that towards the end of the year it became almost necessary to reduce the export duty on jute.

During the two following years, inflationary pressure had come down and some further reductions were made in respect of export duties.

In 1954-55, sizable increases were made in respect of excise duties. Additional taxation in 1954-55 yielded about Rs.11 crores.

In 1955-56, both direct and indirect taxes were raised further. Changes mainly occured in Income Tax and the excise duties. Yield of these tax measures was estimated to be Rs.17 crores over the year.

Over the five year period, the yield through additional taxation at the Centre, excluding export duties (which were variable in their nature), was about Rs.175 crores; and the total yield of resources from the current revenues of the Central Government was estimated to be Rs.304.6 crores, against the target sum of Rs.160 crores in this respect. This meant that Central Government saved about Rs.145 crores more, than the expected amount, from its current revenue resources over the five year period.

Railway earnings

It was expected that a sum of Rs.170 crores will be financed through Railway earnings, to meet the development expenditure. But it has now been estimated that Railway's own earnings contributed only a sum of Rs.115.4 crores, over the first plan period.

In order to make sizable contributions through Railway earnings, Railway fares were increased in 1951-52 and some more adjustments were made in 1952-53 and then again in 1955-56. It was expected that these measures will increase the annual yield

Rs.115 crores over the five year period. Nevertheless, it was admitted that the contribution of Railways did not turn upto the initial expectations because of the increase in working expenses and a fall in earnings during 1952-53 and 1953-54 on account of slight decline in travelling which followed the increase in railway frieght rates.

Additional taxation by the states

It was expected that the combined efforts of all the states will contribute a sum of Rs.410 crores, towards meeting the financial requirements of the First Five Year Plan, by saving from their current revenues. Out of this, a sum of Rs.230 crores was expected to be raised by way of States' additional taxation measures during the First Plan Period. Against these expectations, latest estimates reveal that only Rs.269 crores could be saved out of the current revenues of the states during the five year period.[1] Thus a shortfall of about 34% totalling Rs.141 crores, occured in this respect. Shortfall of such a high order eventuated inspite of the fact that the States had received on unexpected grant of about Rs.80 crores by the Finance Commission.

Apparently, it might be said that failure in the implementation of additional taxation measures in most of the States was the main reason for the shortfall of such a high order. Rs.230 crores were aimed to be raised by the States, over the five year period, by way of additional taxation, but the actual yield out of these measures substantiated around Rs.20 crores only.

1. Review of the First Five Year Plan; Page 26.

An overall picture of the target and actual receipts by way of additional taxation in the states is being detailed below:

		Rs. Crores
Part A States.	**Five Year Target.**	**Annual receipts.**
Assam	3.5	3.3
Bihar	7.3	3.0
Bombay	23.5	24.0
M. P.	10.6	2.3
Madras & Andhra	30.3	8.0
Orissa	9.4	2.0
Punjab	5.0	4.5
Uttar Pradesh	50.2	11.0
West Bengal	36.0	4.5
Total A States	185.7	62.6
Part B States.		
Hyderabad	7.4	1.0
M. B.	4.9	2.7
Mysore	9.2	3.0
Pepsu	4.1	0.4
Rajasthan	3.3	2.6
Saurashtra	4.7	2.1
Travancore Cochin	11.0	6.0
Total B States	44.6	17.8
Total Part A and B States	230.3	80.4

Out of the total yield of Rs.80 crores by way of additional taxation about half was the result of rise in the General Sales Tax, tax on sale of petrol, tobacco, cigarettes and cigars, tax on motor vehicles etc. Shortfalls mainly occured on account of too high expectation of incomes through increased irrigation rates, additional taxation on land, and the Estate Duties.

Increase in irrigation rates in some States was thought to yield Rs.29.5 crores but this increase produced only Rs.6 crores; a sum much below the expectation.

Similarly, additional revenue from taxation of land was expected to yield Rs.34 crores while actual yields on account of this increase aggregated around Rs.5 crores only. Again, the target for revenue from Estate Duty by the States was Rs.21 crores, but the collected amount under this head totalled around Rs.2 crores only.

Item-wise additional taxation yields in the States was as given below:

	Rs. Crores.
1. Tax on land	5.4
2. Irrigation rates	6.0
3. Electricity duty	3.0
4. Motor vehicle tax	9.3
5. General Sales Tax	31.8
6. Sales Tax on Petrol	6.0
7. Sales tax on tobacco, cigarettes & cigars	1.4
8. Estate Duty and Transfer of Property	3.1
9. Surcharge on passengers of busses and public transports	5.3
10. Miscellaneous	9.1
Total	80.4

Public borrowings

The target for raising financial resources, to meet the financial requirements, by way of borrowing money from the public was set at Rs.115 crores. Out of this sum Rs.36 crores were to be borrowed by the Centre and Rs.79 crores by all the states.

This low public borrowing target was placed due to the fact that at the time of the plan formulation, market was so weak that there was little chance for the fulfilment of even such a low expectation.

During the first three years of the Plan, public borrowing programme showed extremely disappointing picture. In 1951-52, public borrowings by the Centre and the States amounted to (minus) Rs. -22.8 crores i.e, the Public authorities lost Rs.22.8 crores

on account of the public borrowing fund.

In 1952-53 and 53-54, public borrowings were negligible.

Position of public borrowings by the Centre were worse.

During 1951-52 the Centre paid back Rs.34.2 crores

During 1952-53 " " " " Rs. 0.9 " and

During 1953-54 " " " " Rs.37.2 "

Thus during the first three years the Centre, in all, paid back a sum of Rs.72.3 crores.

Review of the First Five Year Plan reveals that during the first three years of the plan, Centre and the States, paid back a sum of Rs.5 crores.

These figures show that the States raised a sum of about Rs.67.3 crores, by borrowing from the public during that period.

After that, during the last two years of the Plan, public borrowings gave a satisfactory respond.

In 1954-55, Rs.159 crores were raised by the Centre; the sum included Rs.46 crores representing the maturities. The net borrowing by Centre in 1954-55 amounted to Rs.113 crores.

In the same year, borrowings by states amounted to Rs.7 crores.

Next in 1955-56, the Centre and the States borrowed Rs.89 crores.

Thus total borrowings by the Centre and the States over the five years were as follows:

During the first three years	Rs. -5 crores
During the year 1954-55	Rs.120 crores
During the year 1955-56	Rs.89.4 crores
Total public borrowing during 1951-56	Rs.204.4 crores.

The five year target for this head was surpassed by over Rs.39 crores.

Small savings

The table below shows annual collections made under the head of small savings by the Public Sector -

	Rs. Crores
1951-52	38.5
52-53	40.2
53-54	37.8
54-55	54.6
55-56	66.1
Total 1951-56	237.2

The collections under this head show a steady improvement over the Plan period.

Target (Rs.225 crores) was crossed by about Rs.12.3 crores. Collections during the last year was almost double than the amount raised during the first year of the Plan. It financed about 12% of the total Plan outlay.

Following steps were taken by the Government to attract more yield under the head of small savings:

In 1953-54

(1) Government of India put aside the previous stipulation and it was further decided that the excess collections in a State over its target would be made available to the State in the shape of loans irrespective of the aggregate of all-India collections.

(2) On the organisation side, the working of the authorised Agency System in Bombay, Madras, West Bengal, having been found satisfactory, a similar agency system called the 'General Agency System' was introduced on a regular basis, from Janaury 1, 1954 in

all States except Mysore, Hyderabad, Bilaspur, Manipur and Tripura.

(3) A non-official Central Advisory Committee was appointed in September '53 to guide and strengthen the campaign through Women's Savings Campaign.

(4) Several Women's and other Social Service Organisations were appointed as authorised agents for popularising the Twelve Year National Savings Certificates, for a period of twelve months from October 1, 1953 at 100 centres all over India.

(5) In Madhya Pradesh and Saurashtra, several Gram Panchayats were selected and entrusted for the sale of National Savings Certificates.

(6) On May 10, 1954 a new series of Ten Year Savings Certificates were issued as part of the National Plan loan. This issue was said to be temporary and was not in replacement of the then existing National Savings Certificates. These were sold in denominations of Rs.25 and Rs.50, and maximum investment allowed for an individual in this respect was Rs.1000. These certificates, if held to maturity, were to yield a income tax free simple interest of 4.5 percent per annum.

(7) In May 1954, Government of India announced its intention of issuing 15-year annuity Certificates. For investment of Rs.3500 in these certificates, the holder got a return of Rs.25 per month for a period of fifteen years. Thus, the invester got, in all, a return of Rs.4500. Maximum investment in this respect, allowed for an individual was Rs.20,000.

<u>In 1954-55</u>

In order to encourage States, more, for intensifying the small savings programme, Government of India offered greater

commission to the States. It was agreed that States would be given as loan half the excess over eighty percent of the target set for each state, in addition to the excess collections of small savings over the target stipulated for each state.

In 1955-56

Respond to the small savings movement was found to be satisfactory and collections in this head during the First Plan period totalled Rs.235 crores, exceeding the original Plan target by Rs.10 crores. Out of the total sum Rs.102 crores accounted for savings in Post Office Savings Banks, Rs.96 crores in National Savings Certificates and Rs.36 crores in Savings Deposits.

Provident fund

Provident fund and other similar unfunded debts contributed another about Rs.67 crores at the Centre.

Other capital receipts

It was expected that under the composite head of deposits, funds and other miscellaneous sources a sum of Rs.132.8 cror will be raised. But contribution under such heads aggregated arou Rs.79.6 crores only. Thus, here, a short fall of about Rs.53 crores occured.

It was agreed that the uncertainty about the heads of deposit as mainly responsible for a shortfall of such a high order.

External assistance

It might be recalled that at the time of formulation of the First Five Year Plan, foreign assistance of Rs.156 crores onl could be anticipated.

Considering the position of the anticipated foreign assistance amounting Rs.156 crores and the optimum figures for

deficit financing not exceeding Rs.290 crores, it was found that a gap of Rs.365 crores remained unfinanced. It was said that this gap was to be financed mainly by obtaining more of foreign assistance, additional taxation and then by further deficit financing which was only to be taken as a last resort. Thus, for all practical purposes a sum of Rs.521 crores was aimed to be raised from foreign assistance.

According to latest estimates about Rs.296 crores were received by the public sector as assistance from foreign countries, over the 5 year period. Out of this sum, only about Rs.183 crores could be utilised. The remaining sum of Rs.103 crores was left unutilised, to be used during the Second Plan period.

The following table gives below the details of authorisation and utilisation of foreign assistance during the First Five Year Plan.

Rs. Crores

	Total authorisations(51-56)	Utilisation 51-52	52-53	53-54	54-55	55-56	Total 51-56
ans							
.Govt. Wheat Loan	90.3	59.8	30.5	-	-	-	90.35
io U.S. Aid Programme	39.3	-	-	-	-	4.5	4.5
ternational Bank	12.5	1.0	3.1	1.5	0.7	1.3	7.6
Total	142.1	60.8	33.6	1.5	0.7	5.8	102.45
ants							
do U.S. Aid Programme	102.5	-	4.1	14.4	12.7	27.0	58.2
lombo Plan							
nada	32.34	-	7.1	2.0	2.0	8.6	19.7
stralia	11.08	3.7	0.2	0.2	0.3	0.2	5.1
w Zealand	1.7	0.3	-	-	-	-	0.3
K.	.4	-	-	-	0.01	0.03	0.04
rd Foundation	5.6	-	0.6	0.4	0.5	0.6	2.1
do Norwegian Programme	0.66	-	-	0.05	0.09	0.13	0.27
Total Grants	154.28	4.0	12.0	17.05	16.1	36.56	85.71
AND TOTAL GRANTS AND LOANS	296.38	64.8	45.6	18.55	16.80	42.36	188.11

Out of Rs.188 crores, the foreign aid utilised, Rs.110.4 crores were utilised during the first two years of the Plan, of which Rs.90.3 crores was the Wheat Loan from U.S. Otherwise the rate of utilisation during the first two years was slow and it was due to -

1. delay in the formulation of programmes,
2. shortage of requisite equipment and personnel, and
3. difficult position in steel and shipping.

Rate of utilisation was stepped up during the remaining period.

Of the three loans extended by the International Bank before the First Plan period, the railway loan was fully utilised before the commencement of the Plan. Others, Agricultural Machinary Project Loan and Bokaro Konar Loan (D.V.C.) were not fully utilised. Rs.4.3 crores only were utilised and the balance of Rs.7.5 crores was carried over into the plan period.

The International Bank advanced a second loan of Rs.5 crores for the Damodar Valley Corporation in January, 1953. Agricultural Machinary Project Loan was completely utilised by the end of 1953-54 and most of the Bokaro Konar Loan was utilised by the ~~ned~~ end of 1955-56.

Deficit financing

It was agreed in the First Plan that the magnitude of deficit financing over the five year period should not exceed Rs.290 crores. Yet, despite best care, actual deficit financing was of the order of Rs.420 crores. Not only that, the share of suggested deficit financing in the revised Plan outlay rose to about 21%.

Latest estimates show that deficit at the Centre during the last year of the Plan was of the order of Rs.180.4 crores and though the actual deficits in the States during the last year are not known, it appears that the actual deficit, if anything, was negligible.

Review of the First Five Year Plan gives that "on the whole the aggregate budgetary deficit for the last year of the Plan may be put around Rs.180 crores. For the five year period, the total amount of deficit financing is thus placed at Rs.420 crores. As compared to the estimated Plan outlay of Rs.1960 crores deficit financing works out to be 21% of the total. It will be noticed that over 60% of the total deficit financing in the Plan period is accounted for the last two years of the Plan."[1]

1. Page 34.

CHAPTER VIII

OUTLAY OF THE SECOND FIVE YEAR PLAN

The Plan

With the end of India's First Five Year Plan in 1956, the Second Five Year Plan for economic development began. The Plan which was submitted to the Parliament on May 15, 1956, proposed a development outlay of Rs.4,800 crores by the Central and State Governments over the plan period. This target was against the First Five Year Plan revised outlay of Rs.2,377 crores and the actual outlay of Rs.1,960 crores.

Before coming over the distribution of Plan outlay on different heads of development, it would be desirable to have a look, on the objects, which this huge intended expenditure aimed. The main objectives of the Plan were (1) an increase of 25% in the national income; (2) rapid industrialisation with particular emphasis on the development of basic and heavy industries; (3) a large expansion of employment opportunities and (4) a reduction of inequalities in income and wealth and a more even distribution of economic power.

With a view to achieve the above goals, a sum of Rs.4,800 crores was distributed to be spent on different heads of development as follows:-

Distribution of Plan outlay on different heads of development.

1	Allocation in Rs. crores 2	Percent of total 3
Agricultural and community development	568	11.8
(a) Agriculture	341	7.1
(b) National Extension & community project	200	4.1

(Contd.)

1	2	3
(c) Other programmes	27	.6
Irrigation and Power	913	19.0
(a) Irrigation	381	7.9
(b) Power	427	8.9
(c) Flood control and other projects, Investigation etc.	105	2.2
Industry and Mining	890	18.5
(a) Large and Medium Industries	617	12.9
(b) Mineral development	73	1.5
(c) Village and small Industries	200	4.1
Transport and Communication	1385	28.9
Social Services	945	19.7
(1) Education	307	6.4
(2) Health	274	5.7
(3) Housing	120	2.5
(4) Welfare of backward classes	91	1.9
(5) Social welfare	29	0.6
(6) Labour and labour welfare	29	0.6
(7) Rehabilitation	90	1.9
(8) Special schemes relating to educated unemployment.	5	0.1
Miscellaneous	99	2.1
Total	4800	100.0

The developmental expenditure of Rs.4800 crores, was thought to be spent by the Central and the State Government, roughly as Rs.2559 crores and Rs.2241 crores respectively. Thus, out of the total developmental outlay of the Plan the Central Government's share was over 53 percent.

The table below shows the distribution of the outlay under different heads of development, separately for the Centre and the States.

Rs. Crores

	Centre	States	Total
Agricultural and community development.	65	502	567
National Extension Services and Community Project.	-	1	1
Irrigation and Power.	105	808	913
Industry and Mining.	747	143	890
Transport and Communication.	1203	132	1335
Social Services.	396	549	945
Miscellaneous.	43	56	99
Total	2559	2241	4800

As the two tables given above show, the following facts are notable -

1. Nearly 50% of the total outlay is accounted for expenditures under the heads of Industry and Mining and Transport and Communications.

2. The share of Agriculture and community development in the Plan outlay is only 11.8%.

3. Irrigation and Power get 19% of the total outlay.

4. Against the total allocation of 18.5% of the plan, 12.5% is for the Medium and Large scale industries only.

5. Funds alloted for the development of education form only 6.4% of the Plan outlay.

6. Special schemes relating to educated unemployment get 0.1% of the total. The magnitude is notable.

7. Above 87% of the total sum alloted for Agricultural

and community development is to be spent by states.

8. Regarding expenditures on irrigation and power also, the major portion, i.e. about 83% is in the hands of States.

9. Development of Industries, mining, transport and communications which commands the greatest share out of the Plan, falls ~~is~~ mainly into the hands of the Centre.

10. Social services are, to a quite extent evenly divided among the Centre and the States.

Investment and the current expenditure

Rs.4800 crores, when examined in the light of investments of current outlays, during the Plan period reveal that roughly an investment of Rs.3800 crores was to be made during 1956-61. The remaining sum of Rs.1000 crores represented current expenditure on development during the period.

Investment and Current outlay under different heads of development over the Plan period were as mentioned below:

Rs.Crores

	Investment outlay.	Current expenditure.	Total.
Agriculture and Community Development.	338	230	568
Irrigation and Power.	863	50	913
Industry and Mining.	790	100	890
Transport and Communication.	1335	50	1385
Social Service.	455	490	945
Miscellaneous.	19	80	99
Total	3800	1000	4800

Investments under the heads of Irrigation and Power, Industry and Mining and Transport and Communication are remarkably high.

In view of achieving the aims of the Second Five Year Plan heavy sums were alloted for development of Industries, mining transport and communication etc. This, it was visualised, would be of great help in improving India's foreign exchange position, raising the National income under the industries of non-agricultural origin, improving employment opportunities and bringing more of the economic power into the hands of public.

Though, huge sums were alloted for the development of heavy industries and transport etc., the importance of agriculture was not to be ignored. The Plan was said to be 'non-rigid'. It was emphasised that, "the targets of agricultural production proposed in the Plan will need to be stepped up to offset the inflationary pressure associated with a period of rapid development."[1]

Besides the investment of Rs.3800 crores by the public authorities over a period of five years, it is expected that the level of private investments over the Second Plan period is likely to be Rs.2400 crores. This will bring the total investment in the economy to Rs.6200 crores, and the ratio of investments by the public and the private sectors will be roughly as 61:39.

Revision of the Second Five Year Plan

On the 3rd and 4th May, 1958. a meeting of the National Development Council was held to consider the question of the total outlay of the Second Plan, in the light of experiences and achievements made till that time.

It was agreed that continuous strain on both internal and external resources was being felt. Prices had begun to rise

1. Government of India, Publications Division: Our Second Five Year Plan; Page 4.

even before the commencement of the Second Plan. This had increased the cost of the Plan itself. Besides, there were several other factors which made the revision of the Plan necessary.

Thus for the reason of increased costs of different projects, it was thought that financial outlay required to fulfil the Plan would also increase largely. But it was decided to keep the total outlay of the Plan, in financial terms, to Rs.4800 crores. This necessitated a re-allocation of outlays between the major heads of development as follows:

Rs.Crores

	Centre	States + Union territories	Total	Percentage of total
1. Agriculture and Community Development	65	503	568	11.8
2. Irrigation and Power	90	770	860	17.9
3. Village and Small Industries	60	140	200	4.2
4. Industry and Minerals	857	23	880	18.4
5. Transport & Communication	1175	170	1345	28.0
6. Social Services	321	542	863	18.0
7. Miscellaneous	37	47	84	1.7
Total	2593	2207	4800	100.00

Revised outlays alloted Rs.190 crores more to Industries and Minerals and an equal amount was cut down in small parts from the remaining heads.

This clearly re-emphasised the importance of industrialisation under the Sendnd Plan.

Then again, it was decided to divide the Plan outlay of Rs.4800 crores into two parts. Part A of the Plan, with an outlay

of Rs.4500 crores, which, it was agreed, will include "besides projects and programmes directly related to increase in agricultural production, '~~emore~~ core projects' and projects which have reached advanced stage, and other inescapable schemes. The remaining schemes were to be included in Part B of the Plan with a total outlay of Rs.300 crores. Thus, it was a device to categorise schemes of primary and secondary importance as Part A and B of the Plan respectively.

Rs.4500 crores, total outlay on the Part A of the Plan was distributed on different heads of development as follows:[1]

Rs.Crores

	Outlay Total on Part A of Plan	Centre	States	Percentage of the total
1. Agriculture & Community Development	510	54	556	11.3
2. Irrigation and Power	820	63	757	18.2
3. Village and S.Industry	160	55	105	3.6
4. Industries & Minerals	790	775	15	17.5
5. Transport & Communication	1340	1177	163	29.8
6. Social Services	810	298	512	18.0
7. Miscellaneous	70	30	40	1.6
Total	4500	2452	2043	100.00

The part A of the Second Five Year Plan confirmed the emphasis on industries and Transport and Communications etc.

Annual outlays

Actual figures available for 1956-57 and 1957-58, revised estimates for 1958-59 and the budget estimates for the year 1959-60

1. Government of India, Planning Commission: Re-appraisal of the Second Five Year Plan; Pages 23-25.

revealed that about Rs.3660 crores spent on development during the First Four Years of the Second Five Year Plan. The yearly expenditures were Rs.641 crores (actual), Rs.863 crores (actual) Rs.1064 crores (R.E.) and Rs.1092 (B.E.) respectively.

Yearly breakdown of outlay during the First four years of the Second Five Year Plan, under major heads of development is given below:

Rs.Crores

	1956-57	1957-58	1958-59 R.E.	1959-60 B.E.	Total 56-60	Percentage of total.
1. Agriculture and Community development	67	87	123	142	419	11.5
2. Irrigation & Power	155	153	171	182	666	18.2
3. Village & Small Ind.	28	33	41	44	146	4.0
4. Industry & Mining	75	194	257	199	725	19.7
5. Transport & Comm .	216	270	294	282	1062	29.0
6. S. Service	86	103	153	217	569	15.6
7. Miscellaneous	14	13	20	26	73	2.0
Total	641	863	1064	1092	3660	100.0

The pattern of expenditure on the development heads is very nearly and satisfactorily similar to that of the expenditure pattern given for the part A of the Second Five Year Plan.

Yearly outlays during these years also show a steady step of expenditure on developmental works.

The expected pattern of outlay during the Second Five years plan as a whole, as recently estimated, is given below:

	Outlay during 1956-61	Rs.Crores Percentage
1. Ag. and C.D.	530	11
2. Irr. and Power	865	19
3. Vill. and S.Ind.	175	4
4. Ind. and Mineral	900	20
5. T. and Com.	1300	28
6. S. Services	830	18
Total	4600	100

The above pattern of expenditure also closely tallies with the desired pattern of expenditure during the Second Five Year Plan.

CHAPTER IX

RESOURCES FOR THE SECOND FIVE YEAR PLAN

The Original Scheme of Financing the Plan.

Rs.4,800 crores required for financing the Second Five Year Plan, were initially thought to be raised according to the following scheme -

	Rs. (Crores)
1. Surpluses from current revenues	800
a. At existing rates of taxation (55-56)	350
b. Additional income from new taxes	450
2. Public borrowings	1200
a. Market Loans	700
b. Small Savings	500
3. Other budgetary sources	400
a. Railways' contribution to development programmes	150
b. Provident funds and other heads of deposits	250
4. External resources	800
5. Deficit Financing	1200
6. Gap to be covered by mobilising more domestic resources	400
TOTAL	4800

It was estimated that a sum of Rs.350 crores would be made available, out of the current revenues of the Government, over the five year period. Besides, on the basis of the recommendations of the Taxation Enquiry Commission (1953-54), it was assumed that another sum of Rs.450 crores would be raised by imposing new and additional taxes. New taxation scheme was to begin with begining of the Second Plan.

The Centre and the State Governments were expected to raise equal amounts by way of additional taxation.

Targets for public borrowings were based on the optimism, acquired by experiencing a very favourable respond from public towards this source, during the First Plan.

Contribution of Railways towards development was placed at Rs.150 crores, which was a reasonable expectation. During the First Five Year Plan, Railways contributed Rs.115 crores. In view of the results of the First Plan, in this connection, expectation in the Second Plan was not high. Besides, rise in the income of Railways was bound to follow the rise in national income during the Plan period.

Coming to the share of External Assistance, a sum of over Rs.100 crores was already available in form of unutilised external assistance received furing the First Plan period. Besides, as a result of agreements with the International Bank and many other countries, India expected wholehearted support.

Yet, these resources financed only two third of the proposed Plan. A gap of Rs.1600 crores remained uncovered. Besides, it was agreed that deficit financing could, under no circumstances, be advised to cross Rs.1200 crores, which included Rs.200 crores obtainable by drawing down the sterling balances.

This left an uncovered gap of Rs.400 crores. It was said that the gap was to be covered by further mobilising external assistance as far as possible and raising more of internal resources.

Total receipts of the Central and State Governments over the five year period (1956-61) were estimated at Rs.5000 crores. These estimates were based on the basis of rates prevalent in 1955-56. Out of these receipts the non-developmental

expenditure and the maintenance expenditure under the developmental heads was computed around Rs.4,650 crores. This gave a sound expectation that the balance or surplus of the receipts and the expenditure i.e. Rs.350 crores will be made available towards the Plan expenditure during 1956-61.

Financing the Plan.

By the end of the year 1959-60 it was estimated that the outlay during the first four years of the Second Plan will come around Rs.3,600 crores. On these estimates the break up of the Plan expenditure ~~was~~ during 1956-60 was as given below[1]:-

Rs Crores.

	56-57	57- 58	58-59	59-60	Total 56-60 (Anticipated)
Plan outlay	641	863	1064	1092	3660
Domestic budgetary resources	364	320	536	513	1733
External Assistance	38	47	260	337	682
Total resources	402	367	796	350	2415
Deficit financing	239	496	268	242	1245

It might be restated here that the original scheme of financing the Second Plan proposed deficit financing of only Rs.1200 crores over the five year period. But the concentration of deficits during the first two years left little scope for deficit financing during the later years. Though the above estimates show that the five year limit for deficit financing was crossed only in four years but the latter estimates show that low deficits during the last three years kept its total magnitude far below the target. Deficits during 1958-59 and 1959-60 were Rs.169 crores and Rs.158 crores respectively and according to the revised estimates, deficit during 1960-61 was Rs. 126 crores. These figures give the total deficit financing of Rs.1168 crores. But total deficit financing during 56-61 has now been estimated at Rs.948 crores.

According to latest estimates the expenditure of the Second Plan totalling Rs.4,600 crores was financed in the following order[1]:-

	Rs. Crores
1. Balance from current revenues (on the basis of existing, 55-56 taxation)	- 50
2. Contribution of Railways	150
3. Loans from the Public (net)	780
4. Small Savings (net)	400
5. Provident funds (net) Steel equalisation funds (net) and balance of miscellaneous capital receipts over non-Plan disbursements	230
6. Additional Taxation including measures to increase surpluses of public enterprise	1052
7. Budgetary receipts corresponding to external assistance	1090
8. Deficit Financing	948
TOTAL	4600

The Tax Effort.

Revenue resources of the Centre and the States were expected to finance a sum of Rs.800 crores over the second Plan period. A sum of Rs.350 crores was expected to be saved from the receipts of the Governments at the rates prevalent during 1955-56 and remaining Rs.450 crores was expected to be raised by new taxes and by increasing the rates of some of the old taxes. But, as it has already been mentioned, an additional sum of Rs.50 crores was spent by the Governments on non-Plan heads against the expectation of saving Rs.350 crores out of the current revenues at the 1955-56 rate of taxation. Rise in non-development expen-

1. Currency and Finance report for 1960-61, Page 79. Details from India 1962; Page 182.

expenditure is obviously responsible for the loss of about Rs.400 crores.

Main Taxes at the Centre.

Looking at the revenue and expenditure budgets of the Government of India, it can be noticed that customs, Union excise duties and taxes on income alone are responsible for more than three-fourth of its total resources. Receipts on account of custom duties have been more or less stationary. Contribution from Union excise duties rose steadily with the total revenue. Its share in the total revenue remaining the same i.e. around 42%. But receipts from the income tax have shown a marked declining tendency during the last three years of the Second Five Year Plan. Its share declining from Rs.172.01 crores in 1958-59 to Rs.148.85 crores in 1959-60 and then again to Rs.127.50 crores in 1960-61 (R.E.). The declining tendency is further confirmed by the budget estimates for receipts from x income tax during 1961-62, being put at Rs.133 crores.

Several other important taxes are levied by the Centre. They are - Corporation tax, Estate duty, Wealth tax, Railway Passenger fare tax, expenditure tax, Gift tax, opium tax etc.

Tax revenue forms a very important part of total resources of the Centre. Total revenue and tax revenue of the Centre are detailed below:-

	50-51	55-56	56-57	57-58	58-59	59-60	60-61 R.E.	Rs.Crores
Total Revenue	405.86	481.19	563.23	673.38	670.21	778.59	828.24	
Tax Revenue	357.00	411.47	493.76	575.33	553.06	642.44	685.19	
Tax Revenue as percentage of	88	85.5	87.7	85	79	83	82.7	

Taxation by the States.

Percentage of States' revenue raised as taxes is far too low as compared to that of the Centre. It comes around 64 per cent or so in the case of States against as high as 90 per cent or so at the Centre.

Total revenue of the States and the share of tax revenue therein are being given below:-

	51-52	55-56 R.E.	56-57 B.E.	57-58	58-59	59-60	60-61 R.E.	Rs. Crs.
Total revenue	396.40	546.31	570.65	711.71	812.59	906.99	1010.76	
Tax revenue	281.05	349.53	366.73	471.98	537.06	577.42	605.90	
Tax revenue as percentage of total revenue	71	64	64.3	66.5	66	63.6	59.9	

Over 50% of the total tax revenue of the States is raised by way of taxes on commodities and services. Other important taxes are taxes on property and capital transactions, and the share of income tax.

Additional Taxation.

It was aimed to raise a sum of Rs.450 crores over the five year period by raising the rates of some of the existing taxes and by levying new taxes. This estimate and the efforts to achieve this target was based on recommendations of the Taxation Enquiry Commission 1953-54.

In the year 1956-57, a number of tax changes were made at the Centre, much along the lines suggested by the Taxation Enquiry Commission. Again in 1956 (September) new tax measures were adopted to raise more revenue. These taxes were expected to yield Rs.55 crores during 1956-57 and about Rs.81 crores during the

full year.

The following table gives a brief account of the estimates of yield from measures of additional taxation adopted at the Centre in 1956-57:[1]

	Yield in 1956-57 Rs. Crores	Yield in a full year Rs. Crores
A. Measures included in the budget for 1956-57		
1. Income tax and Corporation tax	9.6	9.6
2. Changes in import duties	1.0	1.0
3. Reduction in import duties	- 1.0	- 1.0
4. Excise duties	24.9	24.9
5. Changes in postal rates	1.0	1.0
Total A	35.5	35.5
B. Measures adopted in Sept. 1956		
Increase in rates of Excise duty on cloth	15.5	27.0
C. Measures announced in Nov. 1956	3.0	16.0
D. Changes in export duties during the year	1.0	3.0
Grand Total	55.0	81.5

Measures included in the Union budget for 1956-57, for additional taxation were -

1. Income and Corporation tax which included -
   a. Increase in Super tax
   b. Tax on registered firms
   c. Withdrawal of tax rebate in respect of undistributed profits of companies, super tax on dividends declared in excess of 6 percent, tax on bonus issued and other changes in corporation tax etc.
2. Import and export duties were changed.

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1. Appraisal and Prospects of the Second Five Year Plan: Annexure IV; Page 33.

3. Excise duties were increased on -

   a. Cotton cloth

   b. Vegetable non-essential oils

   c. Diesel oils and other fuel oils

   d. Art silk, fabrics, soap and straw boards.

4. Change of postal rates

5. Further increase of excise duty on cotton cloth (in September, 1956)

6. Capital Gains tax, additional super tax on dividends declared in excess of 10 percent, higher import and excise duties on certain items, increase in stamp duties in bills of exchange etc. (accounced in November, 1956).

Additional taxation measures announced by the Centre in 1957-58 proposed to raise Rs.79.6 crores in 1957-58 and about 98.4 crores during the one full yea r -

Measures were to -

1. Lower the tax free limit in respect of income tax

2. Check tax evasions

3. Make changes in tax on companies

4. Levy a tax on wealth

5. Raise import duty on several items

6. Increase excise duty on motor spirit, refined and in-specific diesel oil, cement, steel ingots, sugar, vegetable oils, tobacco, matches, paper etc.

7. Introduce railway passenger fare tax

8. Make change in the postal rates

9. Introduce expenditure tax.

On the other hand some reductions were also announced in respect of few excise and import duties. This may also be mentioned that over 60% of the expected yield through additional taxation during 1957-58 was to come from increase in excise duties.

In 1958-59, Gift tax was introduced and excise duties on cement were raised. Additional taxation in the year were only nominal. In all a sum of Rs.6.3 crores was expected to be raised through these measures.

Again additional taxation measures were adopted in the year 1959-60 to produce Rs.23.35 crores, during that year. Measures involved -

1. Rise in duty on refined diesel oil and vapourising oil from 40 nP. to 80 nP. per imperial gallon.
2. Increase in duty on low speed diesel oil.
3. Increase in duty on art silk, motor vehicle tyres, rayon yarn and staple fibre.
4. Excise duty on Khandsari sugar, cigarettes.
5. Increase in wealth tax.

Then in 1960-61 indirect taxation was further increased and it was expected to produce a sum of Rs.23.53 crores.

New excise duties on Aluminium, Cycle parts, Internal combustion engines, electric motors, exposed cinematograph films, tin plates, pig iron and silk fibres were introduced.

Custom duties on Alcoholic liquors and several other items were raised.

Railway freight was increased by 5 percent.

It was estimated that the agreegate yield over five years from the measures of additional taxation adopted by the Central Government during the first three years will be round Rs.725 crores.[1] Final estimates show that the receipts on account of additional taxation have totalled Rs.1052 crores against the target of Rs.850 crores.

1. Appraisal and Prospects of Second Five Year Plan.

Additional Taxation by the States.

Measures of additional taxation by the States were mainly -

1. Increase in general Sales tax
2. State excise duties
3. Agricultural income tax
4. Land revenue and irrigation rates
5. Betterment levy
6. Electricity rates and duties
7. Tax on motor vehicles and passengers and goods
8. Tax on motor spirit and diesel oil
9. Stamp duties and registration etc.

Increase in general sales tax produced nearly 50 percent yield of the total receipts of the additional taxation measures by the States.

The table below gives annual yields through additional taxation measures by the States during the first three years of the Second Five Year Plan:-

Year	Yield in Rs. Crores
1956-57	8.7
1957-58	24.3
1958-59	46.3
Total for the three years	79.3

Yield expected during 1956-61, from additional taxation measures adopted by the States during 1956-59 was Rs.172.9 crores. This was against the original five year target of Rs.225 crores.

The following table gives the measures of additional taxation adopted during the first three years of the Plan, along with

their expected yields over five years and their respective targets -

	Measures adopted during 1956-59.	Yields expected from measures adopted during 56-59.	Targets suggested in the Plan.
1. General Sales Tax	39.6	83.2	112.0
2. Tax on motor spirit and diesel oil	2.9	7.0	37.0
3. Land revenue 4. Irrigation rates	4.0	9.6	11.0
5. Betterment Levy	0.8	2.2	16.0
6. Agricultural income tax	3.3	7.5	12.0
7. Electricity rates and duties	3.4	8.4	6.0
8. Tax on motor vehicles, passengers and goods	5.3	13.1	10.0
9. Stamp duties and registration etc.	1.2	3.0	4.0
10. State excise duties	1.8	3.6	---
11. Others	17.0	35.3	17.0
TOTAL	79.0	172.9	225.0

Railways' Contribution.

It was estimated that railways' contribution towards the planned development programmes, during the first three years of the Second Plan was of the order of Rs.126 crores. Latest estimates have revealed that railways contributed Rs.150 crores over the five year period.

External Assistance.

With a carry-over of Rs.193 crores from the first Plan,

total foreign assistance available for the Second Plan came to Rs.2,457 crores, of which Rs.1,090 crores was in the form of loans while P.L. 480 and 665 and third country currency assistance programmes of the U.S.A. accounted for Rs.1,143 crores, remaining Rs.224 was received as grants.

Estimated utilisation of foreign assistance during the Second Plan period amounted to Rs.1,467 crores, leaving a carry over of Rs.1,295 crores (including the amounts authorised during the Second Plan period for the Third Plan projects) for use after March 1961.

Out of Rs.1,467 crores, the external assistance utilised during the Second Plan period, Rs.1,090 crores were utilised by the public sector and the remaining Rs.377 crores by the private sector.

The following table gives the details of external assistance authorised and utilised during the Second Five Year Plan period[1] -

1. Currency and Finance Report 1960-61. Page 108.

	Undisbursed balance as at the end of the First Plan	Authorised during the Second Plan	Total 1 + 2	Estimated utilisation during the Second Plan	Undisbursed amount as at the end of Second Plan
	1	2	3	4	5
1. Loans					
a. Repayable in foreign currencies	88.6	1004.2	1092.8	608.2	485.1
b. Repayable in rupees	25.1	275.8	300.9	115.4	185.5
Total	113.7	1280.0	1393.7	723.6	670.6
2. Grants	67.1	157.9	225.0	198.1	26.9
3. P.L. 480 & 665 and Third country currency assistance (Gross)	11.8	1130.9	1142.7	544.8	597.9
Total (1+2+3)	192.6	2568.8	2761.4	1466.5	1295.4

It is notable that about 50 percent of the available external assistance remained unutilised.

Small Savings.

1956-57: In order to encourage the States to mobilise small savings a formula was deviced whereby each State was given, as loans, 25 percent of the average net collection in the State for the three years 1953-54 to 1955-56 plus 50 percent of the excess over this average. According to this scheme Rs.19 crores were given to States as loans during 1956-57.

Rs. 61 crores were raised as small savings during the year 1956-57.

1957-58: In June 1957, interest rates on various items of small savings were raised. Subsequently, the yield on annuity certificates was also increased. Internal agents were appointed both by Government and non-Government institutions for securing regular investments from their fellow employees through organised small savings groups. A scheme of gift coupons available in denominations of Rs.5, Rs.10, Rs.50, Rs.100, Rs.1000 (exchangeable in 12-year National Plan Certificates), was introduced with effect from July 1, 1957.

In order to give greater incentive to States the formula of giving loans to States was libralised. States were given laons equal to two thirds of the net collections in their areas.

Rs.69 crores were raised as small savings during the year 1957-58.

1958-59: To revive the popularity of the postal savings banks (1) the facility of withdrawal by cheques, which was first tried out as an experiment in Bombay in 1956-57, was extended to other selected post offices; (2) the facility of bi-weekly

withdrawals was introduced in all post offices doing saving bank business; (3) with effect from January 1, 1959 the maximum limit of investment in 12 year National Plan Savings Certificates was raised from Rs.60 thousand to Rs.1 lakh in the case of charitable institutions and from Rs.15,000 to Rs.25,000 in the case of banks, incorporated companies and registered firms.

Cumulative Time Deposit Scheme was introduced from January 2, 1959. The scheme provides for monthly deposits for a five or ten year period repayable at the end of the period with compound interest yielding a return of 3.3 percent per annum for 5 year account and of 3.8 percent per annum for 10 year account. The maximum limits for individuals are Rs.200 per month in a five year account, and Rs.100 per month in a 10 year account, the limits for ~~point~~ joint accounts being double of those for single accounts. The accounts could be opened in denominations of Rs.5, Rs.10, Rs.20, Rs.50, Rs.100, and Rs.200.

In order to provide greater incentive to the States, they were authorised to retain their entire market borrowings and in addition got two thirds of the net collections from small savings in their areas.

Rs.79 crores were raised as small savings during the year 1958-59.

<u>1959-60:</u> A new pay-roll scheme was introduced for the employees in large establishments, factories etc. providing for deductions to be made from the wages, with the consent of the employees for investment in small savings. Employees were allowed a commission of 1 percent for deposits in National Plan Certificates and ½ percent for Treasury Savings Deposit Certificates to meet the cost of collection etc. The limit of Rs.50,000 for investments of

balances of provident fund in Treasury Savings Deposit Certificates was removed in July 1959. Scheduled and Cooperative Banks were authorised to receive subscriptions for the Treasury Savings Deposit Certificates on a brokerage of 12 nP. percent from October 1, 1959. 15-year Annuity Certificates with a new denomination of Rs.1330 securing a monthly payment of Rs.10 for 15 years was introduced from January 2, 1960.

Receipts on account of small savings totalled Rs.83 crores in 1959-60.

<u>1960-61:</u> During the year it was decided to allow a commission of ½ percent on investments in Cumulative Time Deposit Accounts through Pay Roll Savings Scheme. In order to encourage the retention of National Savings Certificates and the 3½ percent Treasury Savings Deposit Certificates after maturity, it was decided to allow an interest of 3½ percent per annum for each completed year for which the certificates remain un-encashed after maturity, subject to a maximum period of five years. Further in order to encourage the re-investment of the maturing 3½ percent Treasury Savings Deposit Certificates, it was decided to accept them in lieu of cash for investment in the 4 percent Treasury Savings Deposit Certificates. New rules were promulgated on August 1, 1960, according to which investors could make nominations to receive amounts due to them, in the event of their death. The reules relating to the Cumulative Time Deposit Accounts were amended in November 1960, to provide for the immediate payment of the surrender value to the heirs in the event of the death of the depositer in the case of a single account and to the survivor in the case of joint account. It was also decided to set one model district in each State with a view to experiment new methods for

popularising Small savings movements and study their effects. Till the end of the year 16 model districts started functioning in various States.

Receipts on account of small savings amounted to Rs.108 crores in the year 1960-61.

CHAPTER X

FISCAL METHODS

The problem of resources is basic to the whole question of planning. Success of planning, greatly depends on the availability of resources. Magnitude and the size of Plans is determined and should always be determined in the light of the availability of resources.

Resources of a developing country can broadly be divided into two heads, that are -

(1) Domestic resources; and

(2) External resources.

In India, public funds are raised and disbursed by more than one public authority. The Constitution of India is quasi-federal in its character. There are three types of governments, authorised to raise and disburse funds. These are the Union (also called the Central) Government, State Governments and the Local Governments. But the projects undertaken by Local Governments are not included in the plans because they are totally the parts of the respective State Governments and the Constitution also does not take any notice regarding their powers. Thus, according to the Constitution and in view of the scheme of financing the plans, only two, the Union and the State governments are important. The powers of administration as well as the sources of revenue are divided ~~decided~~ between the Union and the State governments.

State Governments are authorised (mainly) to raise following taxes[1] which are subject to certain provisions laid down in the Constitution:

1. Constitution of India; Schedule VII - List II.

(1) Taxes on agricultural incomes.

(2) Duties in respect of agricultural lands.

(3) Estate duty in respect of agricultural land.

(4) Taxes on lands and buildings.

(5) Taxes on mineral rights.

(6) Excise duties on the following goods manufactured or produced in the state and counter railing duties at the same or lower rates on similar goods manufactured or produced elsewhere in India:

(a) Alcoholic liquors for human consumption.

(b) Opium, Indian hemp and other narcotic drugs and narcotics -

but not including medical or toilet preparations containing alcohol or any other substance included in sub-paragraph (b) of this entry.

(7) Taxes on the entry of goods into a local area for consumption, use or sale therein.

(8) Taxes on consumption or sale of electricity.

(9) Taxes on sale and purchase of goods other than newspapers.

(10) Taxes on advertisements other than advertisements published in newspapers.

(11) Taxes on goods and passengers carried by roads or on inland waterways.

(12) Taxes on vehicles.

(13) Taxes on animals and boats.

(14) Toll.

(15) Taxes on professions, trades, callings and employments .

(16) Capitation tax.

(17) Taxes on luxuries, including taxes on entertainments, amusements, betting and gambling.

The Union Government is authorised to raise following taxes[1]-

(1) Taxes on income other than agricultural income (levied on the net income of all individuals, joint Hindu families, unregistered firms and other associations of persons).

(2) Duties of custom including export duties.

(3) Duties of excise on tobacco and other goods manufactured or produced in India, except on goods given in the State list.

(4) Corporation tax.

(5) Taxes on the capital value of the assets (excluding agricultural land of individuals and companies), capital of companies.

(6) Estate duty in respect of property other than agricultural land.

(7) Duties in respect of succession to property other than agricultural land.

(8) Terminal taxes on goods or passengers carried by railway, sea or air; taxes on railway fares and freights.

(9) Taxes other than stamp duties on transactions in stock exchanges and future markets.

(10) Rates of stamp duty in respect of bills of exchange, cheques, promissory notes, bills of lending, letters of credit, policies of insurance, transfer of shares, debentures, proxies and receipts.

(11) Taxes on sale or purchase of newspapers and advertisements published therein.

1. Constitution of India; Schedule VII - List I.

(12) Taxes on the sale or purchase of goods other than newspapers, where such sale or purchase takes place in the course of inter-state trade or commerce.

Thus, it is noticed that though the states have been vested with fairly wide tax powers, the residual powers are left to the Union.

According to the provisions made in the Constitution no tax can be levied or collected except by the authority of law, no expenditure can be incurred from the public funds except in the manner provided by the Constitution and the executive authorities must spend public money only in the manner sanctioned by Parliament.

Besides the sources of revenue of the Union Government mentioned earlier the revenue from the two new taxes on wealth and expenditure introduced from the year 1957-58 and tax on Gifts introduced from the year 1958-59, and profits transferred from the Reserve Bank, go to the Centre. Net profits earned by the railways and post and telegraphs also contribute to the general revenue of the Centre.

Central Government gives a share also, to the State governments out of their incomes through taxes of incomes, Central excise and estate duties and taxes on railway fares. The rate of sharing is predetermined.

Thus besides the sources of revenue of the States as mentioned earlier, there is also their share in the Union income tax revenue, Union excise duties and the tax on railways fares that is raised by the Central Government. These shares form a considerable part of the revenue of States. Apart from the sources of State revenues given above are, civil works and State undertakings; civil administration and grants received from the

Centre. Land revenue, sales tax, state excise duty, registration and stamp duties and shares of income tax and Central excise duties constitute about 34% of the tax revenue and more than half of the total revenue receipts of the States.

The Constitution also provides definite rules regarding the raising and the disbursement of revenues. There are taxes which are to be levied by the Central Government but collected by States. Similarly there are taxes which are levied by the States but collected by the Centre. Also there are taxes which are levied by a certain government but appropriated to the other or assigned to the other. There are also taxes that are levied by the Central Government and divided among the Centre and the States or according to the provision, might be divided between the Centre and the States. For example the income tax (excluding the taxes on incomes of the Union Government employees, corporation tax and the surcharge on income tax) is to be levied and collected by the Union but it is to be distributed among the Centre and the State Governments in a predetermined manner. Some taxes, as succession and estate duties on properties other than agricultural land, and taxes on the sale and purchase of newspapers are levied and collected by the Union but are assigned to States. Next, the Union excise duties are levied and collected by the Central Government but they may be distributed among the Centre and the States. Till recently, the practice was to distribute the excise duties on tobacco, matches and vegetable products but lately excise duties on tea, coffee, sugar, paper and vegetable non-essential oils are also being shared by the States. Also there are taxes like stamp duties and excise duties on medical and toilet preparations which, though levied by the Centre is

to be appropriated to the States.

Capital receipts

Besides, savings from the current revenues of the Centre and the States in order to finance the developmental expenditure under the Plans, much reliance was made on the capital resources of the Governments. Over the period of the First Plan a sum of Rs.520 crores (net) was expected to be raised through internal loans, small savings, deposits and funds and other miscellaneous sources of receipts. Net yield through these sources during the year 1950-51 was expected to be Rs.61 crores (excluding Rs.16 crores worth of extraordinary receipts). The target on this account during the First Five Year Plan meant on an average a rise of about Rs.43 crores per annum.[1]

It has been estimated that during the First Plan period loans from the public contributed Rs.205 crores (net), small savings contributed Rs.304 crores (net) and another Rs.91 crores (net) were raised through other miscellaneous sources of capital receipts. That, in all, placed the net contributions of the internal capital receipts of the Central Government and that of States at Rs.600 crores, that was Rs.80 crores above the target.

Favourable response from the public in this respect, revealed scope for greater exploitation and hence, a sum of Rs.1450 crores was aimed to be mobilised through these resources during the Second Plan period. This included Rs.700 crores from market loans, Rs.500 crores from small savings and Rs.250 crores from Provident Funds and other deposit heads. This seemed too ambitious a target. This meant an average rise of Rs.185 crores per annum over the average receipts during the First Plan on this

1. The Problems of Economic Development; Government of India Planning Commission; Page 54.

account.

The list of the interest bearing obligations (in India) of the Government of India are given below:

Public Debt - (1) Loans.

(2) Treasury bills.

Un~~re~~funded Debt -(1) Service funds.

(2) 10-year treasury savings deposits certificates.

(3) Post office savings bank deposits.

(4) 12-year National Plan savings certificates.

(5) Cumulative time deposits.

(6) National savings certificates.

(7) 10-year national plan certificates.

(8) State provident funds.

(9) Other items.

Deposits - (1) Depreciation development and reserve funds.

(2) Other deposits.

As regards the States, heads under which they receive capital, mainly comprise of Permanent debt, Floating debt, Loans from Central Government, loans from National Agricultural Credit (long term operations) Fund of the Reserve Bank of India, loans from National Cooperative Development and Warehousing Board, Loans from Khadi and Village Industries Board, Employees' State Insurance Corporation etc. and other unfunded ~~unrefunded~~ debts.

CHAPTER XI

DEFICIT FINANCING

The technique of deficit financing was initiated during the First Five Year Plan period in a cautious manner. According to the original First Plan, deficit financing of the order of Rs.290 crores was proposed to be undertaken. This expectation was against the release of sterling balances. It was thus expected that deficit financing of this order would not give rise to inflation in the country's economy. As it is generally believed deficit financing is safe and useful while there is a slack in the economy and production can be increased fairly quickly by utilising idle capacity or manpower, it was thought, in view of the vast unutilised natural and human resources of India and emphasis on agriculture that this much of deficit financing would only be useful for the economy.

After allowing for Rs.290 crores worth of deficit financing a net gap of Rs.521 crores was left uncovered, and according to the original Plan it was expected to be bridged by more possible external assistance, additional internal revenue or capital resources and by minimum possible additional deficit financing.

This willy-nilly statement on the possible sources of finance for filling up the net gap of Rs.521 crores created a certain amount of adverse reaction in the minds of the people and also generated in the initial stages, a good deal of uncertainty about the successful execution of the Plan.

The uncovered gap of Rs.521 crores in the resources of the original First Plan rose to Rs.830 crores with the revised First Five Year Plan and it was expected that in addition to Rs.290

crores, it may in all possibility, become necessary to take resort to additional deficit financing.

It is estimated that over the First Five Year Plan period, deficit financing amounted to about Rs.420 crores which works out at 21 percent of the total First Plan outlay of Rs.1960 crores.[1] This much of deficit financing amounted to direct addition to gross national expenditure through budget deficits. Such budget deficits, during the First Plan period were covered by -

(1) Withdrawal from cash ~~each~~ balances

(2) Sale of securities held in reserve

(3) Increase in floating debt.

Broadly, the sources of covering the budget deficits may be classified into two categories namely, by drawing from the accumulated balances and by taking loans from the Reserve Bank.

According to the available accounts for the First four years of the First Plan and the revised estimates for the fifth year the total amount of deficit financing over the Plan period was estimated around Rs.532 crores out of which Rs.128.5 crores was said to be covered by withdrawal from cash balances, Rs.35.4 crores from sale of securities held in reserve and the remaining sum of Rs.368 crores by increase in floating debt i.e. by drawing from the Reserve Bank.[2]

<u>During the Second Five Year Plan period.</u>

Deficit financing was initiated during the First Plan period in a cautious manner. Since the commencement of the Second Plan, deficit financing is playing a more distinct role as an instrument for financing economic development. According to the

1. Review of the First Five Year Plan: Page 34.
2. Ibid; Page 40.

estimates of the Second Plan, out of a total expenditure of Rs.4800 crores a sum of Rs.1200 crores, that is 25 percent of the total Plan requirements was thought to be mobilised by way of deficit financing.

Out of the amount of Rs.1200 crores expected to be mobilised by way of deficit financing a sum of Rs.200 crores was accounted for drawing down of India's sterling balances. The remaining deficit of Rs.1000 crores represented the net addition of currency in the economy as a result of budgetary deficits of the public authorities. Thus nearly 20 percent of the total financial requirements of the Second Plan was expected to come from creation of new money.

On the basis of the budgetary accounts available for ~~two~~ the years 1956-57, 1957-58 and 1958-59 the total amount of deficit financing in the economy works out around Rs.835 crores, and the estimates for the last two years of the Plan put the figures for deficit financing at Rs.63 crores and the total for five years at Rs.948 crores. Thus Rs.948 crores was the share of deficit financing out of the total Plan outlay of Rs.4600 crores against its proposed share of Rs.1200 crores out of the five year outlay of Rs.4800 crores.

But deficit financing of the order mentioned above during the first three years of the Plan has, it seems not added much towards the increase of supply of money with the public. Reserve Bank of India reports reveal that the total supply of money with the public was about Rs.2184 crores at the end of March 1956. Against this, the total supply of money with public on December 25, 1959 was Rs.2470 crores. This reveals that the increase in supply of money with the public was of the order of Rs.286 crores over a period of about three and a half years. It is believed that during the first two years of the Second Plan, economy was able to absorb deficit financing, of about Rs.749 crores, mainly on account

f the fact that import surpluses were financed from drawing down f foreign exchange resources.

It has been agreed that deficit financing can play an mportant part in supplementing the resources of a developing conomy but it has also been said that its application should be ade in a planned manner with great caution and with appropriate afeguards. Money supply available to the community should ncrease at a steady rate. It is clear that attention was not iven towards this important fact. Consequently concentration of eficit during the last years of the First Plan and again deficits f the order of Rs.253 crores, Rs.496 crores and Rs.136 crores during he first three years of the Second Plan occured. This was mainly esponsible for the accumulation of inflationary pressure since he begining of the Second Plan, resulting in rise of the cost of the Plan and thus making major upsets.

Deficit financing during the planned development period was taken in an irregular manner. Magnitudes of yearly deficits show wide degree of fluctuations. Secondly, during the Second Plan period, deficit financing of a very high order was applied especially when the plan proposed a very high order of investment on industries in the economy and quick yielding projects such as agriculture were comparatively neglected.

CHAPTER XII

EXTERNAL ASSISTANCE

Since the begining of the First Five Year Plan, much reliance has been laid upon country's resources which could possibly be raised externally. Besides expecting foreign assistance of Rs.156 crores, the revised estimates of the First Plan revealed an uncovered gap of Rs.330 crores, to be bridged, to the greatest extent, by further mobilising external resources; by additional internal efforts on the budgetary accounts; and to the minimum possible extent by additional deficit financing. This laid considerable emphasis on part of efforts to be made in respect of securing external assistance of largest possible magnitude.

Since the end of the First Five Year Plan, it has been estimated that total external assistance of Rs.296 crores was available in form of loans and grants for developmental programmes in the public sector over the plan period. Out of the total assistance authorised a sum of Rs.188 crores was utilised for the purpose and thus, a sum of Rs.108 crores was left to be utilised during the II Plan period.[1]

This utilisation of Rs.188 crores of foreign assistance by the public sector over the five year plan period consisted mainly in the procurement of commodities like wheat, steel and other equipment required for the various developmental purposes.

The low rate of utilisation of available foreign assistance according to the Review of the First Five Year Plan[2]

1. Review of the First Five Year Plan; Page 29.
2. Page 31.

as mainly due to delays in the formulation of programmes, the
nortage of requisite equipment and personal and the difficult
osition in steel and shipping.

Of the total authorisations, the share of United States as larges t and amounted to Rs.232.1 crores.[1] Out of this about .153 crores[1] were utilised over the First Plan period and the tilisation was mainly for procuring wheat worth Rs.90.3 crores nd remaining on steel and other items relating to the requirements f economic development. Some other countries also gave steel and ther equipments in form of loans and grants. However, except for he International Bank Loan of Rs.7.6 crores which was used for the griculture Machinery Project and for Bokaro-Konar Project in).V.C. and some aid given by U.S.A. in financing the Rihand Power Projects and few others of minor importance by different Governments and authorities, most of the foreign assistance was utilised for the import of food.

Taking as a whole, external assistance received by India as at the end of the First Plan amounted to Rs.405 crores, of which Rs.190 crores remained unutilised and was available for the Second Plan.[2] This leads to suggest that out of Rs.215 crores of external assistance utilised during the First Plan period Rs.188 crores were utilised by the public sector and only about Rs.27 crores by the private sector.

The Second Plan Period

It was estimated that during the first three years of the Second Plan Rs.458 crores were spent for the Plan and another Rs.642 crores were expected during the remaining two years of the

1. Review of the First Five Year Plan; Page 30.
2. Report on Currency & Finance; 1958-59.

period.[1] This brought the total external assistance for the Plan around Rs.1100 crores.

On account of the abundant capital and technical requirements for developmental purposes the external payments position of the country has been under strain since the begining of the Second Plan. The foreign assets of the Reserve Bank declined by Rs.221 crores during 1956-57 and Rs.260 crores during 1957-58. The rate of drawal on these reserves declined considerably in the first half of 1958-59, whereas in the following quarter there was a small increase. Between April 1956 and February 1960 the reserves dropped by Rs.543 crores in all, from Rs.746 crores to Rs.203 crores (on 20th February, 1960). This drop was mainly on account of rise in imports both on private and public account. The increase in imports during 1956-57 mainly rose out of the requirments of developments projects under the Second Plan, although the following other factors were also responsible -

1. Increased defence expenditure
2. Larger imports of foodgrains
3. Increased requirements of raw materials, components etc.
4. Higher imports on consumer goods
5. Increase in freight rates and prices.

To reduce the strain on foreign payments position, a progressively restrictive policy on imports has been adopted and steps taken to expand exports. The foreign exchange costs of projects in the Second Plan have also increased as a result of higher prices abroad of capital goods and industrial raw materials.

During the first three years of the Second Plan, India

1. India 1960: Page 209.

received assistance from the International Bank for Reconstruction and Development and some other countries, which to a very great extent relieved the pressure on India's foreign exchange position. Several foreign countries have been taking interest in the planned economic development of our country and held meetings to find out ways and means for financing India's development.

As a result of one such meeting convened by the I.B.R.D. held in Washington in August 1958, foreign assistance of $ 360 million was given to India. The participating countries of the meeting were U.S.A., U.K., Canada, West Germany and Japan. Besides, in another such meeting held in March 1959, substantial promise for additional assistance was made to cover the foreign exchange requirements during 1959-60.[1]

Including a carryover of Rs.190 crore from the First Plan, the foreign assistance available for the Second Plan amounted around Rs.1216 crores at the end of March 1959. Of this Rs. 697 crores were utilised during first three years of the Second Plan and Rs.519 crores was available for utilisation during the rest of the plan period.[2]

1. Report on Currency and Finance 1958-59.
2. Ibid.

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EXTERNAL ASSISTANCE AUTHORISED AND UTILISED
APRIL 1951 TO MARCH 1959

Source	Aid authorised at the end of the First Plan.	Aid utilised up to the end of First Plan.	Balance available for utilisation during the Second Plan	Aid authorised between April 56 and March 59.	Total available for utilisation during Second Plan	Ext.assistance between April 56 and March 59.	Balance available for utilisation at the end of March 59
1	2	3	4	5	6	7	8
1. Loans and Credits -							
a. From I.B.R.Q.	57.7	33.8	23.9	183.8	207.7	162.5	45.2
b. From U.S.A.							
i. Wheat loan 51	90.3	90.3	-	-	-	-	-
ii. Eximbank loan	-	-	-	71.4	71.4	1.2	70.2
iii. Loan from D.L.F.	-	-	-	83.3	83.3	6.9	76.4
iv. Asian Economic Development Fund Loan for Orissa Iron Ore Project.	-	-	-	9.5	9.5	-	9.5
v. Loan under T.C.A. programme.	39.3	3.0	36.3	22.6	59.9	39.9	19.0
vi. U.S. Bank's loan to Air India International	-	-	-	5.3	5.3	-	5.3
c. From Canada							
Wheat loans	-	-	-	15.7	15.7	15.7	-

(Continued from previous page)

1	2	3	4	5	6	7	8
d. **From U.K.**							
i. Lazard Brother's Credit (Durgapur)	-	-	-	15.3	15.3	9.4	5.9
ii. E.C.G.D. Loan First (Durgapur)	-	-	-	20.0	20.0	20.0	-
iii. E.C.G.D. Loan Second (Capital goods)	-	-	-	38.0	38.0	5.0	33.0
e. **From West Germany**.							
i. Credit for Rourkela Steel Plant	-	-	-	74.8	74.8	42.0	32.8
ii. Industrial Project Credit of Jan.1959	-	-	-	19.0	19.0	4.5	14.5
f. **From Japan**.							
i. Yen Credit of 1958	-	-	-	23.8	23.8	0.2	23.6
ii. Loan for Orissa Iron Ore Project.	-	-	-	3.8	3.8	-	3.8
g. **From U.S.S.R.**							
i. Credit for Bhilai Steel Plant	63.1	-	63.1	-	63.1	52.1	11.0
ii. Credit for industrial enterprises	-	-	-	59.5	59.5	0.1	59.4
TOTAL LOANS AND CREDITS (1)	250.4	127.1	123.3	645.8	769.1	359.5	409.6

(Continued from previous page)

1	2	3	4	5	6	7	8
2. Grants.							
a. T.C.A. Grants (Excluding P.L.665)	85.6	42.0	43.6	8.7	53.3	51.6	0.7
b. Colombo Plan Grants	45.5	25.2	20.3	37.5	57.8	28.4	27.4
c. Norvegian Grants	0.7	0.7	-	1.0	1.0	1.0	-
d. Ford Foundation Grant	5.5	2.3	3.2	4.2	7.4	2.7	4.7
TOTAL GRANTS (2)	137.3	70.2	67.1	51.4	118.5	83.7	34.8
3. P.L. 480 and P.L. 665 Assistance (Import of Wheat etc. and not loans or grants to any firm)	16.9	16.9	-	329.0	329.0	254.1	74.9
GRAND TOTAL (1) + (2) + (3)	404.6	214.2	190.4	1026.2	1216.6	697.3	519.3

Source: Report on Currency and Finance: 58-59, Pages 77-78.

Total aid in form of loans and P.L. 480 credits authorised during the year 1959-60 amounted to Rs.463 crores. This included Rs.179 crores from U.S.S.R., Rs.23 crores from Czechoslovakia and Rs.19 crores from Yugoslavia, to be used during the Third Five Year Plan. As a result of the Washington Conference of I.B.R.D. and some other countries, held in March 1959, external assistance worth Rs.221 crores was secured by India which included Rs.142 crores under the P.L. 480 programme. This assistance was extended by the I.B.R.D. and by the Governments of U.S.A. and the U.K.[1]

Besides, Governments of West Germany and Japan also promised further aid for financing the foreign exchange deficit during the last two years of the Second Plan. Other than these, external assistance was authorised in 1959-60 by the U.S.S.R., Czechoslovakia and Yugoslavia for the Third Plan as mentioned above and Rs.21 crores by the U.S.S.R. for the Second Plan. This all proves the willingness of other countries to assist the financing of India's economic development.

One important point in this connection which immediately attracts attention, is the magnitude of external assistance which came for agricultural commodities, mainly food grains. This has been estimated that total foreign assistance authorised during the First four years of the Second Plan, including a carryover of Rs.190 crores from the First Plan period amounted to Rs.1528 crores. Of this Rs.852 crores comprised of loans, while P.L. 480 and P.L. 665 assistance amounted to Rs.488 crores that is about one third of the total.[2] This assistance was received in the form of agricultural commodities consisting mainly of food grains.

1. Report on Currency and Finance: 59-60.
2. Ibid.

The purpose of loan, as given in the Report on Currency and Finance for the year 1959-60, was as follows -

Rs. Crores

Purpose of loan	Aid for utilisation after March 1956.	Estimated utilisation between April '56 & March '60.	Undisbursed amount as at the end of March '60
1. Steel and Steel Project	274.0	225.9	48.1
2. Transport -			
a. Railway development	143.0	111.1	31.9
b. Ports development	20.5	2.9	17.6
c. Airways development	8.0	8.0	-
Total 2	171.5	122.0	49.5
3. Power projects	40.8	20.9	19.9
4. Industrial development	336.4	138.6	197.8
5. Iron Ore Projects	13.3	-	13.3
6. Wheat loans	15.7	15.7	-
Total loans	851.5*	523	328.5*

After March 1960, additional external assistance of Rs.678 crores, was authorised. Of this Rs.607 crores were extended by U.S.A. for the supply of agricultural commodities under P.L. 480. Of the rest Rs.71 crores, Rs.43 crores came from the U.S.A. Development Loan Fund, Rs.14 crores from Poland and Rs.14 crores from West Germany.[1]

Latest estimates reveal that total foreign assistance authorised during the Second Five Year Plan amounted to Rs.2568.8 crores which including Rs.192.6 crores as a carryover from the

1. Report on Currency and Finance: 1959-60.
*2. Excluding credits totalling Rs.221 crores for use in the Third Plan Period.

First Plan totalled Rs.2761.4 crores. Of this Rs.1466.5 crores were estimated to have been utilised during the Second Plan leaving a sum of Rs.1294.9 crore to be used during the Third Plan. Out of Rs.1466.5 crores utilised during the Second Plan, Rs.1090 crores were utilised by the public sector and the remaining by the private sector.[1]

1. Report on Currency and Finance for 1960-61; Page 108 and 79.

PART III

(A critical study of Government's fiscal measures during First and the Second Five Year Plan)

CHAPTER XIII

TAX POLICY

The accepted aim of fiscal policy in an underdeveloped economy is to restrain consumption on a country-wide scale and obtain the increasing resources to be ploughed back into the development activities. Accordingly criteria governing the tax policy at this stage may be put down as follows[1]:

(a) Sizable additions to public revenues;

(b) Incentives for large earnings and more savings;

(c) Restraining of consumption on fairly wide field, so as to keep in check, domestic inflationary pressure and to release the resources required for investment;

(d) Initiation of such changes in the tax structure as would make tax yields progressively more responsive to increased income and facilitate an orderly development of economy with due regard to the social objectives that the country has adopted.

So far as the criterion of making sizable additions to the public revenues are concerned, the tax policy of the Government was of little help, especially during the First Plan period. Budgetary surpluses of the Government contributed far less sums than was expected out of them, and about 22 percent of the expenditure of the First Plan had to be financed by deficit financing. To a great extent, a similar state of affairs was responsible for similar deficit financing during the Second Plan.

National Income of India at current prices was Rs.9,530 Crores in 1951-52 and Rs.9,980 Crores in 1955-56. On the other hand, total revenues raised by the Union and the States were Rs.914.9 Crores and Rs.1,041.32 Crores during the respective years. For a rise of about Rs.450 Crores in the national income, public revenues went up by about Rs.125 Crores. The share of increase in

1. Given by T.T. Krishnamachari in his budget speech on

national income, taken by the Government was thus more than 25 per cent. Taking India's national income in 1960-61 to be around Rs.14,200 Crores,[1] the rise in national income over the ten year period was Rs.4,200 Crores; and the rise in public revenue over the period comes around Rs.900 crores.[2] Thus the share of increased national income raised as public revenue has declined to about 21 percent.

In an underdeveloped country taxation has inevitably to play a very important role in the financing of economic development. Poor peasants, small artisans, unskilled workers, persons engaged in primitive professions and small business entrepreneurs of a poor country cannot, and do not, shoulder the responsibility of modernising the country. Government has to step in to take up the task of economic development; and the task of economic development of an underdeveloped country is far too expensive, especially in the face of country's poverty.

The basic problem of an underdeveloped country is its poverty. Not only that, poverty is its own cause and effect. The key to the solution of poverty lies in stepping up the rate of investment in the country, which in turn depends on an increase in the rate of saving in the country. The task of increasing the rate of saving in an underdeveloped country, where propensity to consume is exceptionally high, is very difficult. Measures to induce the habit of savings will have little effect, because the major section of population is extremely poor, uneducated and lies outside the country's monetised sector.

1. India's national income in 1960-61 (Preliminary) was Rs.14,200 Crores: India 1962, Page 161.
2. Total of the Union and States revenue in 1960-61 was Rs.1,839 Crores, Currency and Finance Report for 1960-61. Statement 57 and 61.

In India about 82.16 percent of the population lives in rural areas and only 17.84 percent in the urban areas.[1] In rural areas 64.1 percent of the total expenditure is on food articles. For rural and urban areas combined, this percentage is 61.3. Among other articles of expenditures, prominent are pan, tobacco, intoxicants, fuel and light, amusements, medicine, toilet, ornaments, ceremonials etc. These consumption items account for a large residual of the income of people. Ceremonials and services account for over 11 percent of the total expenditure.[2] Very little amount is spent on articles of capital nature. Savings in India has been too low. It was about 5.3 percent of the national income in 1950-51 and about 7 percent of the national income in 1953-54.[3]

Under such conditions of high propensity to consume and a low rate of saving, large rural sector, lack of education, and risks in private entrepreneurship, the problem of raising the rate of savings in the country could only be done by a strong policy of taxation and thus forcing up the rate of saving.

<u>Additional taxation</u>

During the First Five Year Plan, Union and the State Governments were expected to save Rs.568 Crores from their current revenues over the Plan period. Out of this sum Rs.160 Crores were to be saved by the Centre and Rs.408 Crores by the States. Thus comparatively speaking, a very high responsibility was given to the States. Besides, the uncovered gap of about Rs.600 Crores, was also to be covered by additional measures of taxation in case more[4] foreign help was not forthcoming. This added to the resource

1. Currency and Finance Report for 1960-61. Statement 10.
2. Report of the Taxation Enquiry Commission, Vol.I, Page 63.
3. Report of the Taxation Enquiry Commission, 1953-54, Vol.I, page 139.

responsibility of Governments at both levels.

The State Governments miserably failed in fulfilling their additional taxation targets of Rs.230 Crores. They could raise only Rs.80.4 Crores by new tax efforts.[1] Except Bombay and Punjab, yields from additional tax measures were deplorably low as compared to the targets, in all the States. The reason, was ill balanced and unplanned imposition of additional tax measures.

The share of Central Government for saving out of the current revenues was initially put at Rs.160 Crores over the Five Year period - this target was expected to go up, following the upward revision of the First Plan outlay and the low availability of external assistance.

The Union levied fresh taxes to increase its savings from its current revenues. Fresh taxes were introduced in 1951-52 to yield Rs.31.15 Crores; in 1953-54, Rs.1.50 Crores; in 1954-55, Rs.11.85 Crores;[2] and then in 1955-56, Rs.17 Crores.[3] The yield of additional tax measures at the Centre was about Rs.175 Crores and the total savings by the Centre, taking savings at the 1950-51 rates of taxation and the yield of new taxes, amounted to Rs.304.6 Crores.

In case of the Centre too, the introduction of new and additional taxation was irregular. Practically no new tax measures were introduced in 1952-53. In rest of the years new taxes with widely varying tax-yields were introduced. The expected yields varied from Rs.1.50 Crores to Rs.32 Crores. This irregular and slack tax policy has mainly been responsible for the shortage in the availability of resources for the development Plans.

1. Review of the First Five Year Plan.
2. Budget for the respective years.
3. Review of the First Five Year Plan.

In the Second Five Year Plan, it was proposed that addi tional taxation should yield a sum of Rs.450 Crores over the Plan period. This was to be raised in equal shares by the Centre and the States. The notable difference in the two Plans, in respect of sharing the additional taxation responsibility, was that in th Second Plan half of the proposed additional taxation was to be raised by the Centre and half by all the States; while in the Fir Plan a much high share was allotted to the States as compared to t Centre. The shift in the policy was doubtlessly desirable especially in view of the results of the First Plan.

Another gap of Rs.400 Crores, which was left uncovered in the begining, was for all practical purposes to be covered by additional measures of taxations. This raised the additional taxation target to Rs.850 Crores over the five year period. The results of the additional taxation by the Centre and the States, during the Second Plan period, reveal as if the responsibility of raising the other Rs.400 Crores was singularly assumed by the Cen raising its additional taxation target to Rs.625 Crores and leavi States' target at Rs.225 Crores as proposed before. Latest estimates serve to show that additional taxation targets have been ov fulfilled, both by the Centre and the States. This fact has clea shown the superior tax raising capacity of the Centre as compared to the capacity of States. Similar conclusion can be derived on the basis of additional taxation yields by the Centre and States during the First Plan.

The adoption of additional taxes during the Second Plan too, was sufficiently irregular. Expected net addition from the new tax proposals introduced in 1956-57 was Rs.34.15 Crores. The new taxes were introduced to raise Rs.93.85 Crores in 1957-58,

Crores in 1960-61.[1] The yearly yield of the proposed taxes varied from Rs.6.57 Crores to 93.85 Crores. In view of the successful yields of the additional taxation in one particular period, one may not doubt the scheme of introducing new tax proposals, but such an irregular scheme is liable to cause great damage to the economy by creating disequilibrium. It may leave the economy in an inflationary or a diflationary condition.

Similarly tax addition by the States was also irregular. New taxes adopted in 1956-57 were expected to yield Rs.11.5 Crores (Rs.10 Crores by the Part A States and Rs.1.5 Crores by the Part B States), new taxes of 1957-58 were expected to yield Rs.12 Crores, new taxes of 1958-59 were expected to yield Rs.14·0 Crores, new taxes of 1959-60 were expected to yield Rs.4 Crores and new taxes introduced in 1960-61 were expected to yield Rs. 1·05 Crores.

Despite overfulfilment of additional taxation targets both by the Centre and the States, the fact cannot be ignored that the Second Plan has left Indian economy in the grip of inflation.

Tax revenues

The rise in tax revenue (Centre and States) has been slow, though it has been steady during the two Plan periods. The following table gives the national income, total tax revenues of the Centre and States and the percentage national income raised as tax revenue, by the Governments:

1. Budget for the respective years.

Year.	National income. At current prices in Rs. Crores.	Total tax revenue in Rs. Crores. 1	Percentage of national income raised as tax revenue.
1950-51	9,530	629.00	6.6
1951-52	9,970	741.04	7.5
1952-53	9,820	691.98	6.9
1953-54	10,480	693.58	6.4
1954-55	9,610	736.48	7.5
1955-56	9,980	777.57	7.8
1956-57	11,310	860.49	7.6
1957-58	11,360	1047.31	9.2
1958-59	12,600	1090.12	8.6
1959-60	12,940	1219.86	9.4
1960-61 (Preliminary)	14,200	1291.09	9.1

The rise of tax revenues during the First Plan was extremely slow. The share of tax revenues to the national income starting from 7.5 percent in 1951-52 declined to the minimum at 6.4 in 1953-54 and then rose to 7.8 percent in 1955-56. The rise of tax revenues during the Second Plan has comparatively been more encouraging.

Attainment of a level of about 9.5 percent of the national income as tax revenue at the end of 10 years of planned economic development in India, as compared to the corresponding levels of 35 percent in United Kingdom, 22 percent in Australia, 23 percent in the United States and in Japan, 27 percent in New Zealand, 19 percent in Canada and 20 percent even in Ceylon,[2]

1. Computed on the basis of percentage of national income raised as tax revenue in that year, given in Review of the First Five Year Plan; Page 38.
2. The Five Year Plan; Planning Commission; Page 49.

is quite low. This fact to a great extent accounts for a very low rate of savings in the country. The objection is not that the share of tax revenues to the national income in India has not equalled the level prevailing in United Kingdom, U.S.A. or any other developed country, but that the rate of increase in India has been extremely slow. The share of tax revenue to national income has risen by about one and a half times over a period of 10 years; with this rate of increase, it would probably be after 1981 (the rate of increase is liable to go down with the rise in its own magnitude) when it can attain a level nearing 20 percent. In a largely private owned economy like India, quick rise in the rate of savings by the Government alone can help a rapid development of the country.

Principles of taxation

The canon of equity or the ability to pay, inherited from the times of Adam Smith, still holds a very important place in the formulation of taxation principles. From every point of view - social, moral or rational - the principle of equity holds its significance. But this is definite that equity is n ot the only consideration in levying a tax. There are several others too. Now, this remains to be decided that what place should be assigned to equity and to what extent it should be followed?

The term equity, since it came into use, has been inter preted in various ways. Lately, it generally means the balancing of marginal sacrifice with marginal returns. It has been given top priority by most of the specialists of the subject. But as Professor B. Dasgupta has ably expressed "The principle of balancing marginal sacrifice with marginal return, while undoubtably important, is too static a concept to be applied to a developing

economy"[1]. Truly, general principles of public finance cannot, and should not, be applied in case of a developing economy without making necessary adjustment in them.

The basic requirement of poor economy is that of incre sing public revenue - and therefore, one very important consideration in levying a tax should be its yield. India, in respect of its taxation policy, has laid over-emphasis on the question of equity. A number of exceptions, exemptions and abatements, practically all the taxes, have made the tax structure in India, extremely complicated.[2] In view of equity, the rates of direct taxes, begining from a very low level go to a very high level. Income tax rates, for example, begin from a level of 3 percent on low incomes and go up to about 84 percent on the highest sla The rates on the upper brackets are almost confiscatory. Few taxes, such as the expenditure tax, the gift tax and the estate duty, hardly make any net additions (deducting the cost of thei collection) to the public revenues. It is true that these taxe do serve to bridge the inequalities of income and wealth among the people, but this function too is carried out on a very low scale.

The consideration of equity, which has made income t rates rise very steeply, has made the system highly pernicious High tax rates are to a great extent responsible for large sca tax evasions. According to the estimates of Professor Kaldor, if the maximum rate of tax on income be brought to 45 percent, Government will loose only about Rs.18.3 Crores in the tax re This estimate indicates that loss would be not much, if the m

1. B. Dasgupta: Our Plans and Our Public Finance; Page 91.
2. All important taxes have been dealt with in detail in the following pages.
3. Indian Tax ~~Report~~; Page 17.

rate is placed somewhere in between, say at 70 or 75 percent. It hardly seems justifiable to impose such high rates for petty rise in tax revenues. On the other hand, the rates of wealth tax and estate duty which are highly capable of reducing inequalitie have been kept sufficiently low; far below the rates suggested b Mr. Kaldor.

These facts have kept the growth of the volume of public revenues in India at a low level, at a moment when the availability of financial resources was the country's major prob It was agreed that India should have a bold taxation policy and that the taxation system should be subjected to a thorough and comprehensive reform, but Government's taxation policy, during two Plan period, can hardly be classed as 'bold', and only few changes were made to reform the taxation system.

Besides the consideration that a tax should be sufficiently revenue yielding -- it should be simple too -- Simple t administer and simple to be accepted. In the words of Dr. Dasgu "In a particular tax simplicity is often more important than equity"[1]. An attempt to make every tax equitable makes the tax system highly complicated. An ideal tax system may have progre taxes, proportionate taxes and regressive taxes; all together. What is needed is that, the effect of the tax system as a whol should be equitable. This overall equity cannot be brought abo by any calculation. It can be approached by improving the tax system from time to time, in the light of foregoing exper But having a number of exemptions, exceptions and abatement provisions in the tax system, with a view to make each and ev tax equitable, can only lead to complication and confusion. E tions provide loopholes to duty deniers. They provide chances

1. B. Dasgupta: Our Plans and Our Public Finance; Page 92.

for tax evasions.

The policy of Government in respect of taxing the luxuries and the non-necessities has also been sufficiently slack. This is confirmed by the fact that the demand for luxury goods such as motor-cars, scooters, refrigerators and the like, is day by day taking lead over their production. Higher taxes on luxury goods may not, in themselves, be very paying but they seem just in view of social objectives and necessary from the point of view of improving the pattern of production. In short, it can be said that the Government's taxation policy has lacked boldness and has over emphasised the principle of equity. These facts have served to complicate the tax system and reduced the possibility of a rapid increase in the volume of public revenues.

CHAPTER XIV

TAXES ON INCOME OTHER THAN CORPORATION TAX

Income tax was first levied in India in 1860 and was abolished after a few years. In 1886 it was reimposed and since then it continues to exist. Income tax rates in India remained nominal till 1916. During the inter war perio the rates were comparatively very low than what they are toda and its structure was also quite different. Since the begin- ing of the Second World war, income tax in India acquired gre importance. It has been a major source of Government revenue in connection with the war and the post war finance. At present, it constitutes a good part of the Union and the Stat Government revenues[1].

The present rate structure of income tax was adopt in 1939. The personal income tax is levied on the net inco of all individuals, joint Hindu families, unregistered firms and other association of persons excluding limited companies and corporations. Agricultural incomes are not included in incomes, taxed by the Union Government.

All incomes below a certain level are exempted fr income tax. This tax exemption level has changed from time time in view of exempting the poorer class from paying this tax and on account of the administrative difficulties. Cha

1. About 11%. Budget estimates of the revenues of the Un and States for the year 1959-60 were Rs. 690.77 crores Rs. 833.88 crores respectively. Union income tax was t contribute Rs. 166.25 crores.

in the exemption levels were as follows:-

Year	Level, below which incomes were not taxed
1939-40 to 1941-42	Rs. 2,000
1942-43 to 1943-44	Rs. 1,500
1944-45 to 1946-47	Rs. 2,000
1947-48	Rs. 2,500
1948-49 to 1949-50	Rs. 3,000
1950-51 to 1952-53	Rs. 3,600
1953-54 to 1956-57	Rs. 4,200
1957-58 onwards	Rs. 3,000

During the two Plan periods, the minimum exemption limit underwent changes in the year 1953 and then in 1957. In 1953-54 the limit was raised to Rs.4,200 from its preceding level of Rs.3,600. This change was brought about in view of administrative difficulties in dealing with the low income cases. The Finance Minister said "I have felt for some time that far too much of the time of the Income Tax Department is being taken up by the relatively smaller assessments and if the number of such assessments could be reduced, the Department would be able to give greater attention to the cases of the bigger assessees and improve the revenue from income tax"[1]. He was conscious of the fact that with this change about 70,000 cases, out of a total of about 8 lakhs assessees, would be reduced. Thus to him, it was a measure towards checking evasions among the high income assesses and it also reflected his faith in progressively rising taxes on incomes.

1. Budget Speech, Budget for 1953-54, Page 78.

It might be recalled here that, the all India cost of living, till the year 1952-53 had not grown very high[1], and India's per capita income was also showing steady rise. As a matter of fact, this step was an experiment. It has rightly been commented that "the structure of public finance in many underdeveloped countries including India has grown up haphazardly, influenced by historical accidents, the example of other countries, the thinking of foreign rulers, and the exigencies of the moment"[2].

This experiment, though made at a suitable time when budget surpluses were in sight, could not have a healthy effect During the process of development, such a tax structure is required which is most suited to the requirements of rapid economic growth. At that time slight relief to the upper incom group would have been more desirable than the relief to the lower income group with its high propensity to consume. The obvious effect of this change was the sharp drop in the volume of this tax revenue during the subsequent years as shown below:

Year	Revenue through income (other than corporation) tax[3]
1951-52	Rs.146.19 crores
1952-53	Rs.141.43 "
1953-54	Rs.122.34 "
1954-55	Rs.122.26 "
1955-56	Rs.131.36 "

It is clear that the loss due to this change was far above than what it was estimated by the Finance Minister.

1. Index number for 1952-53 was 103 with its base 1949=100, Reserve Bank of India: Currency and Finance Report, 1954-55 Statement 10.
2. R.J. Chelliah: Fiscal Policy in underdeveloped countries, P.
3. Reserve Bank of India: Currency and Finance Report, 1956-57.

Taxation Enquiry Commission 1953-54 disfavoured this step and recommended that the tax exemption limit should be reduced to Rs.3,000. The report suggested that "taking into account the per capita income levels of the community, and the desirability as far as practicable of direct taxation of small incomes, there is a case for reducing the minimum taxable income limit ....we recommend that the exemption limit should be Rs.3,000".[1] They further added that "we are satisfied that administrative considerations are not so weighty as to militate against any lowering of the exemption limit.[2]"

Income tax is one of the major sources of the Government revenue and thus, the tax exemption limit has much to do with it. Tax exemption limit in India is as high as ten times as compared to its per capita income. This fact, together with sharp differences in income of its people and the existence of a very high percentage of earners in the low income group, considerably limits the number of income tax payers. This, in turn, to a great extent, serves as a cause for imposing very high rates on the people of high income group.

The Taxation Enquiry Commission, 1953-54, pointing out the cause of higher income taxation has mentioned that "the class of income tax payers is very small relatively to the population, being 1 and 1½ per cent".[3] Secondly most of the assessees are concentrated in the lowest income group where charges are only nominal.[4] Martin and Lewis, in one of their studies, 'Patterns of Public Revenue and Expenditure', covering

1. The Taxation Enquiry Commission Report, Volume II, Page 136.
2. Ibid.
3. The Taxation Enquiry Commission Report, 1953-54, Volume II, Page 134.
4. In 1952-53, 32.9% assessees fell, only in the lowest income group and contributes only 2.9% of the tax demand: Ibid, Table 1, Page 135.

16 different developed and underdeveloped countries (including India), have pointed out that "the general practice in the underdeveloped countries is to have a high exemption limit for personal incomes so that a man earning an income comparable to £200 a year usually escapes altogether from income taxation"[1].

On the other hand increasing revenue requirements for development and great reliance on income tax, especially when about 99 percent of the people don't have to pay it, make the tax rates very high on the higher income groups and in turn give rise to numerous allied problems like that of tax avoidance, evasions and the loss of incentives etc.

Income Tax Rates.

The present rate structure of income tax in India, h undergone several changes since 1939. Tax rates went on incre sing, mostly on account of the increasing expenditure on defen during the war. The tax rates were maximum in the year 1946- There was no surcharge on the income and super taxes in that year, yet the marginal tax rate on the highest slab was 15½ annas in a rupee, that is about 97%. The year 1946-47 was the turning point, so far as the income tax rates in India are concerned. Such high rates, have not been reached again even during the period of country's planned economic development.

The personal income tax rates, as adopted in 1946-4 were as follows:

1. Adopted from R.J. Chelliah: Fiscal Policy in Underdevelop Countries, Page 79.

Income	Tax Rate (Per Rupee)	Percent
Income upto Rs.2,000	Exempted from taxation.	-
On the first Rs.1,500 of the total income	Nil	-
On the next Rs.3,500 of the total income	1 Anna	6.25
On the next Rs.5,000 of the total income	2 Annas	12.5
On the next Rs.5,000 of the total income	3.5 Annas	21.87
On the balance of the total income.	5 Annas	31.25

Next, in addition to the incometax, a super tax was payable on incomes above Rs.25,000. Super tax rates were as follow

Income	Tax payable (annas per rupee).	
	Earned Incomes	Unearned Incomes
First Rs.25,000	Nil	Nil
Next Rs.10,000	2	3
" Rs.10,000	3	4
" Rs.15,000	4	5
" Rs.20,000	5	6
" Rs.30,000	6	7
" Rs.40,000	7	8
" Rs.50,000	8	9
" Rs.50,000	9	9.5
" Rs.1,00,000	9.5	10
" Rs.1,50,000	10	10.5
On the balance	10.5	10.5

The above tax rates show that incomes above Rs.15,000 we taxed at the rate of over 31%. Then incomes which exceeded Rs.35, were taxed at the rate of 50% for the unearned incomes. Tax rate applicable to incomes exceeding one lakh was 75% and 81% on the

earned and unearned incomes respectively. The maximum rate of about 97% was applicable on the balance of incomes over 5 lakh.

These exceedingly high rates reveal the Government's reliance on this tax. This tax was considered to be an ideal tax and efforts were being made to make the rates more progressive. These high rates proved to be highly pernicious on the incentives and in the following year the income tax revenue was reduced by over 9 crores.

During the planned development period the principles guiding the public finance activities are mainly two: they are the reduction of inequalities of income and wealth and to secur funds for investment on the development. Together with these, caution has to be made in respect of safeguarding the individua incentives and encourage private savings. This x is appreciabl that Indian Government has, from time to time, taken steps to enquire into the effects of its taxation policies. The setting up of the Taxation Enquiry Commission in 1953-54 and the invitation to Mr. Nicholas Kaldor, of the Cambridge University in 1956 were two notable steps in this direction.

The Year 1951-52.

Income tax and super tax rates remained the same as they were before. But, in additions to these, a surcharge of 5% on the income and super taxes was reintroduced after a gap of five years i.e. from 1946-47 to 1950-51. The introduction of surcharge was imposed with objective of increasing revenue for the purpose of development. Tax rates prevelent in 1951-5 the begining year of planning in India, were as follows:

Income Tax

	(Rate per rupee)	Percentage
On first Rs.1500 of the total income	Nil	Nil
On next Rs.3500 of the total income	9 Pies	4.7
On next Rs.5000 of the total income	1 Anna 9 Pies	10.9
On next Rs.5000 of the total income	3 Annas	18.75
On the balance of the total income	4 Annas	25

Super Tax

	Rate (per rupee)	Percentage
On first Rs.25,000	Nil	Nil
On next Rs.15,000	3 Annas	18.75
On next Rs.15,000	4 Annas	25
On next Rs.15,000	6 Annas	37.5
On next Rs.15,000	7 Annas	43.75
On next Rs.15,000	7.5 Annas	46.9
On next Rs.50,000	8 Annas	50
On the balance of the total income	8.5 Annas	53.1

The tax exemption limit from 1950-51 to 1952-53 was Rs.3,600. In addition to the tax payable at above mentioned rate a surcharge, equal to 1/20th of the income and super tax payable was charged. The above mentioned rates continued till the end c the year 1954-55.

The Year 1955-56.

The 1955-56 budget was acclaimed as the 'married man' budget as it provided some concession in the income tax to marr people. Income and Super tax rates were stiffened up, though tl raising of tax exemption limit from Rs.3,600 to Rs.4,200, which w affected from 1953-54, was maintained. Changes were mainly mad the recommendations of the Taxation Enquiry Commission 1953-54.

In a nutshell, the recommendations of the Commission were that -

(1) The tax exemption limit should be reduced to Rs.3,000 fr its (then) existing level of Rs.4,200;

(2) The maximum marginal rate should not go above 35% on incomes above Rs.1.5 lakhs;

(3) The burden of taxation on the lowest income ranges shou not be increased appreciably, particularly in view of increasing burden of indirect taxation;

(4) There is little scope for increasing the rates in the case of top most brackets, but upper middle bracket rates might slightly be affected;

(5) The first tax free slab, should be Rs.2,000 for the married assessees and Rs.1,000 for the unmarried assessees. The introduction of family allowance within three years was recommen

(6) Earned income allowance should be given only upto a specified limit.

(7) The maximum amount for abatement in respect of life insurance premia and the provident fund should be given upto one fifth of the total income of Rs.8,000 whichever is lesser.

Rates coming into effect from the year 1955-56, for married assessees, were as given below -

Income Tax

	Rate (per rupee)	Percent
First Rs.2,000	Nil	Nil
Next Rs.3,000	9 Pies	4.7
Next Rs.2,500	1 Anna 9 Pies	10.95
Next Rs.2,500	2 Annas 3 Pies	14.1
Next Rs.5,000	3 Annas 3 Pies	20.3
Balance	4 Annas	25.0

For unmarried assessees the first two slabs were Rs.1,00 and Rs.4,000 respectively. In addition to the income tax a surchar equal to 5% of the income tax payable, was charged.

SUPER TAX

The number of super tax slabs remained the same as it was in 1954-55 but the first tax free slab was reduced from Rs.25,000 to Rs.20,000. Secondly, the maximum rate applicable on incomes over Rs.1.5 lakhs was raised from 8.5 annas a rupee or 53% to 9.5 annas a rupee or 59.4%. The slabs were amde small in the lower income groups and bigger in the higher income groups. Thes steps made the taxes more progressive. The surcharge rates were maintained.

The first major change regarding the difference in taxable minimums of the unmarrieds and the marrieds, which came as a first step towards the introduction of family allowance, as recommended by the Taxation Enquiry Commission, 1953-54, was a wi and a just step and served to end the knoty controversy over the treatment of the incomes of husband and wife when both are earni It puts married people, who had greater propensity to spend, in advantage of about Rs.48.

The breaking up of the income slab between incomes of Rs.5,000 into two slabs and thus making the rates rise less steep was also no less desirable. But the changes that were made in t super tax rate, though remote, served to make the overall incide of these taxes more progressive.

It is, however, consoling that the scheme of compulso surcharge-cum-deposit as recommended by the Commission was not adopted. Both these were suggested to be charged at the rate of 0.25% from the level of Rs.25,000 and rising upto a maximum of

5.6% on incomes above Rs.5 lakhs. Comulative effect of all these would have raised the effective burden of taxation on the highest income tax slab from 82% to 96% and the rates would have become comparable to the 1946-47 rates.

The following tables give the analysis of the tax payable on different personal incomes of married persons at 1954-55 rates and at the rates recommended by the Taxation Enquiry Commission, 1953-54. It is clear that their recommendation was to make the tax much more progressive with the rise of income.

PERSONAL INCOME TAXATION AS RECOMMENDED BY THE TAXATION ENQUIRY COMMISSION - (FOR MARRIED PERSONS)

Slab	Income & Super Tax on slab in percentage.	Cumulative income	Tax payable on slab	Cumulative tax paid.	Tax as percentage of income	Other charges as percentage of income.*	Amount paid in other charges	Total tax as paid.	Total tax as percentage of income	Amount left after taxation.
2	3	4	5	6	7	8	9	10	11	12
Rs. 2000	-	2000	-	-	-	-	-	-	-	2000
3000	6	5000	180	180	3.6	-	-	180	3.6	4820
2500	12	7500	300	480	6.4	-	-	480	6.4	7020
2500	16	10th	400	880	8.8	-	-	880	8.8	9120
5000	22	15th	1100	1980	13.2	-	-	1980	13.2	13020
5000	26	20th	1300	3280	16.4	-	-	3280	16.4	16720
5000	38	25th	1900	5180	20.7	-	-	5180	20.7	19820
5000	44	30th	2200	7380	24.6	0.5	150	7530	25.1	22470
10000	50	40th	5000	12380	31.0	1.0	400	12780	32.0	27220
10000	60	50th	6000	18380	36.8	1.6	800	19180	38.4	30820
10th	70	60th	7000	25380	42.3	2.4	1440	26820	44.7	33180
20th	76	80th	15200	40580	50.7	4.6	3680	44260	55.3	35740
20th	82	100th	16400	56980	57.0	5.6	5600	62580	62.6	37420
50th	84	150th	42000	98980	66.0	7.8	11700	110680	73.8	39320

2	3	4	5	6	7	8*	9	10	11	12
50th	86	200th	43000	141980	71.0	8.8	17600	159580	79.8	40420
		5 lakhs	258000	399980	80.0	11.0	55000	454980	91.0	45020
		10 lakhs	430000	829980	83.0	11.2	112000	941980	94.2	58020

*Special surcharges and compulsory deposits levied in the same proportion.

PERSONAL INCOME TAXATION AT 1954-55 RATES (FOR MARRIED PERSONS)

	Income & Super tax on slab(rate)	Cumulative Income	Tax payable on the slab	Cumulative Tax	Surcharge	Total Tax paid.	Tax as percentage of income.	Amount left after taxation.
2	3	4	5	6	7	8	9	10
Rs.1500	Nil	1500	Nil	-	-	-	-	1500
Rs.3500	9 ps.	5000	164	164	-	164	3.3	4836
Rs.5000	1 an. 9 ps.	10000	547	711	36	747	7.5	9253
Rs.5000	3 as.	15000	938	1649	82	1731	11.5	13269
Rs.10000	4 as.	25000	1250	2899	145	3049	12.2	21956
Rs.15000	7 as.	40000	6562	9461	473	9934	24.8	30066
Rs.15000	8 as.	55000	7500	16961	848	17809	32.4	37191
Rs.15000	10 as.	70000	9375	26336	1317	27653	36.6	42347
Rs.15000	11 as.	85000	10313	36649	1832	38481	45.3	46519
Rs.15000	11 as. 6 ps.	100000	10781	47430	2372	49802	49.8	50198
Rs.50000	12 as.	150000	37500	84930	4247	89177	59.5	60823
Rs.50000	12 as. 6 ps.	200000	39063	123999	6200	130193	65.1	69807
Rs.100000		500000	234357	358368	17918	376286	75.3	123714
		1000000	390625	748973	37449	786422	78.6	213578

Lakdawala - Taxation and the Plan: Page 93

Thus it is clear that overall effect of the taxes a the special surcharge and compulsory deposits as recommended b the Taxation Enquiry Commission, would have been highly pernic ous. Compulsory deposits, in their short time effect, were no less than a direct tax. Though this recommendation of the Taxation Enquiry Commission was not accepted yet it can be noti that in the 1955-56 budget the generally notable feature, that the incidence of taxes on personal incomes in India is very ve low on lower incomes and increases gradually upto incomes wort Rs.40,000 or so and sharply thereafter, remained, for all practical purposes, as it was.

The Taxation Enquiry Commission's recommendations, regarding the abatement to be given for the insurance premium and the provident fund contribution, were accepted and the admissible abatement was raised to one fifth of the income sub to a maximum of Rs.8,000 from one sixth of the income subject a maximum of Rs.6,000. As it would be discussed later, such abatements have very little effect on one's savings, and ther fore this change was of little importance.

The earned income allowance as provided by the Fina Act, 1955 was that one fifths of the earned incomes, not exce ing Rs.25,000 subject to a maximum of Rs.4,000, be deducted bef levying the tax. The Finance Act, 1956 further provided that earned income allowance on incomes above Rs.25,000 should be deducted by one fifths of the excess, till it becomes nil for the earned income worth Rs.45,000.

In the words of Dr. Lakdawala "the earned income relief is regarded as a sort of allowance for depreciation of human capital and the precariousness of its earning power as

against that of material capital"[1] and thus, in the light o[f] one's ability to pay, its existence is justified.

The Year 1956-57.

Income tax and the surcharge on it continued at th[e] 1955 level. Some changes were brought about in the super ta[x] rates. Firstly the number of slabs were increased from 9 to This was done by splitting up the 7th, 8th and the 9th slabs into smaller slabs and slightly higher rates were applied to incomes which exceeded Rs.70,000. The maximum rate which appl[ied] to incomes above Rs.1,50,000 was reduced to annas ten per rupe[e] from its previous rate of annas ten and a half per rupee. Th[e] surcharge continued at its previous level of 5% of the tax payable.

The Kaldor Report.

In 1956, Government of India invited Mr. Nicholas Kaldor of the Cambridge University to undertake a study of di[rect] taxes in India. The report submitted by him was issued by th[e] Finance Ministry in that very year under the title 'Indian Ta[x] Reform'.

Mr. Kaldor clearly felt and expressed that the inc[ome] tax system in India was highly pernicious. He felt that the rates were highly progressive and resulted into severe dis-incentive effects on work, savings and enterprise. Such a progressive structure, according to him, was responsible for mass tax evasions and avoidances. He was of the opinion tha[t] "these confiscatory tax rates truly apply only to a small mi[nority] of people who can not avoid these incidences, and their long [run] effect is bound to be wholly pernicious both in penalising t[he]

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prospects of certain careers which are vital from the nationa: point of view and undermining public morality."[1]

He has further pointed out that "I am strongly of tl view that the developments of the last 15-20 years which impo: (nominally) fantastically high marginal rates of tax, while permitting the continuance of wide loopholes for tax avoidance are highly pernicious in character"[2] and he has rightly sugges "that from every point of view it is far better to have a fool proof system of taxation with a moderate rate schedule, than a system which has the appearance of high progressivity, but whi can not be effectively or impartially administered".[3] He felt that there was"a great deal to be said for keeping the rates (taxation low, both in the interest of economic development (s as to maintain economic incentives) and also to lessen the temptation to tax payers to sabotage the tax laws by all available means".[4]

He recommended that taxes on income and wealth, oth than the estate duty, comprising of income tax, capital gains tax, annual wealth tax, personal expenditure tax and gift tax should be administered together; tax base should be broader i each case and; rates should be lower. He was of the view tha the above mentioned five taxes should "all be assessed simult neously, on the basis of a single comprehensive return".[5] He pointed out that "they are 'self-checking' in character, both in the sense that concealment or understatement of items in order to minimise liability to some of the taxes may involve added liability with regard to others, and in the sense that

1. N. Kaldor: Indian Tax Reform; Page 11.
2. Ibid: Page 11.
3. Ibid: Page 2.

information furnished by the tax payer in the interest of preventing over assessment with regard to his own liabilitie automatically brings to light the receipts and gains made by other tax payers"[1].

As regards the income tax (including super tax and surcharges), Mr. Kaldor suggested that the maximum rate shou not go above 45% of the income as against the prevailing rat of 92%.

The Year 1957-58.

Some major changes were introduced in the personal income tax which, as it would be compared later, brought the effective rates below the levels during the preceding year.

Firstly, tax rate on the highest slab for personal income tax and super tax was brought down to 34% from 91.8%.

Secondly, the tax exemption limit was reduced fro Rs.4,200 to Rs.3,000.

Thirdly, the tax slab for married assessees was ra to Rs.3,000 from its previous level of Rs.2,000.

Method of providing earned income allowance was c Family allowance to married individuals was further extende individuals with children also.

The number of income tax slabs was increased and of super tax slabs, reduced. The maximum income tax rate wh in 1956, applied to incomes above Rs.15,000 was brought to incomes above Rs.20,000. Maximum Super tax that in 1956 app. to incomes above Rs.1.5 lakhs was reduced to incomes above Rs.70,000.

Following rates were adopted by the Finance (No.2

1. N. Kaldor: Indian Tax Reform; Page 2.

Act of 1957.

Income Tax

Slabs	Rate (per cent)
On the First Rs.3,000	Nil
On the next Rs.2,000	3
On the next Rs.2,500	6
On the next Rs.2,500	9
On the next Rs.2,500	11
On the next Rs.2,500	14
On the next Rs.5,000	18
On the balance of the total income	25

The above rates are for married individuals. In ca of unmarried individuals the first two slabs are to be of Rs.1,000 and Rs.4,000 respectively.

(Source: Reserve Bank of India Bulletin, June'57, Page 539)

Super Tax

Slabs	Rate (per cent)
On the first Rs.20,000	Nil
on the next Rs.5,000	5
On the next Rs.5,000	15
On the next Rs.10,000	20
On the next Rs.10,000	30
On the next Rs.10,000	35
On the next Rs.10,000	40
On the balance of the total income	45

(Source: Reserve Bank of India Bulletin, June '57, Page 539)

Surcharge and the Earned Income Relief:

In 1956-57 the surcharge amounted to 5% of the pa income tax and super tax, and the earned income relief was a in the form of income tax abatement on earned incomes below

Rs.45,000. A new method of providing earned income relief was introduced from 1957 according to which the surcharge was lower on earned incomes and higher on unearned incomes.

On earned incomes the surcharge payable amounted to 5% of the income and super tax payable on incomes upto Rs.1,00,000 and 10% on incomes which exceeded that limit. On unearned incomes the surcharge was 20% of the taxes payable. No surcharge was payable on incomes upto Rs.7,500.

Another slight change was in the abatement of income tax on account of life insurance premium and provident fund contribution which was increased to one forth of the income subject to a maximum of Rs.8,000 against the earlier provision of one-fifth of the total income subject to a maximum of Rs.8,000. This again, was in view of encouraging savings in life insurance and provident fund.

Family Allowance:

The first, tax free, slab for income taxation in case of married assessees without child was put at Rs.3,000. Besides, it was thought to give a child abatement of Rs.300 per child, to a maximum of two children. Thus, the first tax slab for married individuals with one child was Rs.3,300 and for married individuals with two children it was Rs.3,600. The sum of the first two slabs in each case was, however, to be Rs.5,000.

The above mentioned marriage, as well as child allowance, were admissible only in case of incomes which did not exceed Rs.20,000. In case of individuals whose income exceeded Rs.20,000, the first tax-free slab was Rs.1,000 only, irrespective of the fact that the individual was unmarried, married or had children.

The change, however, resulted in decreasing the

effective basic rates as compared to the 1956 rates. A comparison of the two rates is given below:-

Income Tax

Income Slab	1956 Rates[1]	1957 Rates[2]
Upto Rs.2,000	Nil	Nil
Rs.2,000 to 3,000	5%	Nil
Rs.3,000 to 5,000	5%	3%
Rs.5,000 to 7,500	11%	6%
Rs.7,500 to 10,000	14%	9%
Rs.10,000 to 12,500	20%	11%
Rs.12,500 to 15,000	20%	14%
Rs.15,000 to 20,000	25%	18%
Balance of the total income	25%	25%

Super Tax

Income Slabs	1956 Rates	1957 Rates
Upto Rs.20,000	Nil	Nil
Rs.20,000 to Rs.25,000	6%	5%
Rs.25,000 to Rs.30,000	19%	15%
Rs.30,000 to Rs.40,000	19%	20%
Rs.40,000 to Rs.50,000	31%	30%
Rs.50,000 to Rs.60,000	37%	35%
Rs.60,000 to Rs.70,000	44%	40%
Balance of the total income	47%-62%	45%

The maximum rate (including surcharges) was thus brou down from 91.3% in 1956 to 84% on unearned incomes and 77 on ea incomes in 1957-58 and onwards.

The following table gives a comparative analysis of income tax (including super tax and surcharges) payable on sele incomes in 1953-54, 55-56 and 1957-58:-

1. The rates are for married individuals.

INCOME TAX PAYABLE ON SELECTED INCOMES

Levels of Income	In 1954-55		In 1955-56		In 1957-58	
	Total Tax Rs.	Percentage of income	Total Tax Rs.	Percentage of income	Total Tax Rs.	Percentage of income
1	2	3	4	5	6	7
Rs.3,000	Nil	Nil	Nil	Nil	60	2.0
Rs.5,000	164	3.3	197	3.9	120	2.4
Rs.10,000	747	7.5	825	8.2	594	5.9
Rs.20,000	3017	15.0	3177	15.8	2424	12.1
Rs.30,000	5283	17.6	7139	23.7	6624	22.1
Rs.40,000	11257	28.1	11969	29.9	12024	30.1
Rs.50,000	17507	35.0	17744	35.5	18624	37.2
Rs.100,000	49802	49.8	54494	54.5	58824	58.8
Rs.500,000	376286	75.3	407233	81.4	394824	79.0
Rs.1 Million	786422	78.6	850202	85.0	814824	81.5

Note: Figures are approximate.
Figures for 1955-56 are for unmarried individuals.
Figures for 1957-58 are for unearned incomes of unmarried individuals and all others whose incomes exceed Rs.20,000.

Thus, it is clear that the incidence of personal income taxation from 1957-58 and onwards has been lower than what it was in 1956-57. But the importance of income tax has been rising constantly during the development period as evident from the five yearly moving averages given below. The following figures give the collection through income tax revenue -

Year	Rs.Crores	5 yearly moving average
1951-52	146.19	-
1952-53	141.43	-
1953-54	126.60	133.57
1954-55	122.26	134.68
1955-56	131.36	139.13
1956-57	151.74	148.21
1957-58	163.70	153.53
1958-59	172.01	152.76
1959-60	148.85	-
1960-61 R.E.	127.50	-

In an attempt to rationalise income tax structure in India several changes were made from time to time and efforts were made to check tax evasions and avoidances. Yet it can very easily be noticed that the problem of tax evasions has always been a source of loss to revenues. Despite a surcharge of 5% which was imposed on payable income taxes in 1951-52, collections in 1952-53 were decreased.

Decline of income tax revenue in years following 1953-54 might be accounted for by the raising of tax exemption limit. The upward adjustment in this respect was done specifically to deal with the evasion and avoidance cases amongst the high income groups. But, it is clear that such intention could hardly succeed. In an attempt to maintain high rates of taxation

revenue could come out. This loss can be taken as a lesson against highly progressive income taxes. The root cause of vide spread tax evasion mainly lies in the practice of high taxes on incomes.

Rates were again revised upwards in 1956, and the tax revenue did increase, but not as much as it should have been. The slight downward revision in 1957 could also increase the volume of revenue. This example clearly shows that income tax revenues can profitably be earned by making the rates less progressive. But the fact that income tax revenues could not be maintained at their 1957-58 level and declined during the following years is a sufficient proof that even the rates adopted in 1957 are sufficiently high. The reduction of rates in 1957, as compared to 1956 rates, was only nominal. The introduction of new direct taxes - wealth tax, expenditure tax, gift tax etc. have only resulted into the increment of direct taxation.

"In many cases combined impact of wealth and income tax liability even exceed the total income. For example the incidence of total tax (which relates to income tax, super tax, surcharges and wealth tax only in 1960-61 and does not include expenditure tax and gift tax) on income group of Rs.2 lakhs (earn is Rs.2,09,471, i.e. 104.2% and on income group of Rs.5 lakhs (earned) is Rs.5,90,471, i.e. 118%.[1]

It might be repeated here that it is the effect of hig taxes that provides loopholes in the system and tempts the tax payers to sabotage the tax laws by all available means. These views are the same as those of the Cambridge University Economis Mr. Kaldor.[2]

1. S.P. Jain: A.I.C.C. Economic Review; April 7, '61; Page 36.
2. N. Kaldor: Indian Tax Reform: Page 5.

The structure of Indian income tax was introduced on the British model during the days of British rule over India. The economic development of the country was not the main issue. It was desirable, after the transfer of power into our hands, and with the begining of planned economic development in India, to develop a tax structure suitable to Indian conditions and congenial to the atmosphere of rapid economic development. Towards this end, a Taxation Enquiry Commission was appointed in 1953; and in 1955, Mr. Nicholas Kaldor of Cambridge University was invited. But none of the two reports suggested any basic change in the income tax structure. The Taxation Enquiry Commission, with its suggestions of high income taxes and special surcharge, compulsory deposits etc., indicated the need for still higher taxation, while Mr. Kaldor suggested that the highest tax rate should not go beyond 45%.

None of the two suggestions, in this respect, can be taken as suitable under present Indian conditions. Neither the country can afford the luxury of such a low percentage as 45% nor it should tax at a rate as high as 90% or so. On one side there is danger of losing ~~loosing~~ revenues, allowing income differences to exist, raising expenditure demand on luxury goods, etc., while on the other hand there are unavoidable chances for tax evasions, corruptions and loosing revenue in turn. Nevertheless, there is always a more comfortable and desirable position between the two extremes.

<u>Provision for Savings</u>:

Besides the fact that personal income tax in India is highly progressive, it contains little provision in respect of fostering personal savings. Abatements have been given in taxable incomes towards the payments for life insurance premiums

and the compulsory provident funds. But these are neither enough nor of any practical use.

Life insurance policies can only be taken up by persons who have regular incomes and can manage to continue the premium payments. This condition to a very great extent limits the incentive to save inspite of the given tax abatement in this respect.

The abatement in respect of provident fund contribution is also of little practical use on account of the fact that these contributions are generally compulsory and they will be made even if there is no abatement on this account. Moreover the provision of contributing towards the provident fund is limited to a very small class of salary earners.

It has been noticed that during the plan periods sufficient emphasis has been given on these two forms of encouraging personal savings. The initial rebate of one-sixth of total income subject to a maximum of Rs.6,000, was raised to one fifth of total income subject to a maximum of Rs.8,000 and again to one fourth of the total income upto a maximum of Rs.8,000.

The present rate of rebate, it can be seen, is applicable to income earners upto a maximum of Rs.32,000. Previously it was given to income earners upto Rs.40,000. In view of India's per capita income of less than Rs.300 per year, incomes such as Rs.32,000 or Rs.40,000 can not be considered as small ones. Taxes payable at these income levels at the present rate of taxation are only Rs.6,624 and Rs.12,024 respectively. Tax payable at Rs.24,000 is Rs.3,864. Tax rebate to an extent of Rs.8,000 would mean a serious loss to the public exchequer. Besides, this expectation that ~~a~~ an individual earning Rs.32,000 would save Rs.8,000 and would pay Rs.3,864 as the tax (that is in all Rs.11,864

serves to support the case for a higher taxation at such a level of income.

Taking the case of a married individual (as in India practically all get married) earning Rs.10,000 per annum, can save about Rs.2500, if he saves upto the maximum permissible tax abatement limit that is Rs.2,500. In this case the incentive to save is too little.

Next, taking the case of still lower incomes, such as Rs.5,000 or so, it is far from being real that an individual would think of investing Rs.100 per month to save a tax payment, as little as Rs.3/- per month. This clearly shows that this sort of saving incentive can only be popularised if income tax rates on lower incomes are higher than what they are at present. It may appear convincing that an individual will save Rs.100 per month to escape a tax of Rs.20 or so but never to escape Rs.3/-. So far as the middle income groups are concerned, the present tax rebate seems to be too high and clearly indicates the scope for higher tax rates on those groups.

On the whole it can be concluded that personal income tax in India is very low on lower incomes and very high (especially in view of other taxes such as wealth tax, expenditure tax, capital gains tax, gift tax etc.) on high incomes. Besides it provides little incentive and exemption in respect of personal savings. The structure of income tax is highly complicated and cares too much to judge the ability of the tax payer and the type of income. The fact that income tax revenues have been falling from time to time inspite of rising national income, provides sufficient proof to the effect that too lenient and too severe dealing towards various income groups has been practiced. The aim of taxation for development finance should be to foster

conditions congenial to sound development. Too much consideration on means, affects the process of ~~and~~ end realisation very adversely. The saying that "he who pleases everybody, pleases no body" has stood the test of time and this principle can remarkably fit into the principles of development finance.

TAXATION OF COMPANY INCOME

Basically there are two taxes on a company or Corporation in India. They are the (1) Income tax; and (2) Super tax. But a company may have to pay some other taxes under particular circumstances of dividend distribution or the like.

Income tax on companies, is supposed to have been paid by the company, on behalf of its share-holders. The dividend which share-holders receive is equal to their gross dividend minus income tax on the gross dividend at the maximum marginal rate. Then the gross dividend of each individual share holder is calculated and income tax payable on it is found. The excess of income tax paid by the company on behalf of the share-holder, over the income tax payable by him on his gross income, is refunded to him. Thus share-holders get credit for the income tax paid by the company on their behalf. But, no credit is given to share-holders for the income tax paid by the company on the undistributed profits. The tax on the undistributed part of company's profit is borne by the company itself.

Income tax on companies, till March 31, 1957 was levied at a flat rate, equal to the maximum marginal rate of personal income tax. Thus companies were taxed at the rate of 4 annas a rupee, that is 25% from 1950-51 to 1956-57. This was a reduced rate against the preceding rate of 5 annas a rupee. There was no surcharge on income tax in 1950-51. But in 1951-52 the first year of planned economic development in India, a surcharge equal to 1/20th of the income tax, was imposed.

From 1957-58 the income tax on company profits was increased from 4 annas in a rupee to 30%. The surcharge on

income tax equal to 1/20th of tax payable, remained unchanged. These rates continued till the end of the Second Plan.

Till 1955 a rebate of one anna a rupee was given on undistributed profits, with a view to encourage the ploughing back of profits in the company. This rebate was allowed in case of companies other than 23 A Companies. The rebate was abolished by the Finance Act, 1956 and a new scheme was introduced, to discourage the distribution of dividends, through the imposition of differential rates of corporation tax.

Besides income tax, companies are liable to pay a super tax or the corporation tax. Corporation tax is payable on the total income of the company and unlike the income tax, no part of it is refundable to the shareholders. Rate of corporatio tax from 1951-52 to 1952-53 was 2.5 annas per rupee and it was later increased to 2.75 annas per rupee in 1953-54.

The corporation tax has also been subject to various rebates. Smaller companies were charged at a lower rate than the big companies. The second rebate was given to Indian companies against the foreign companies. This has been given with a view to encourage domestic enterprise. The justification for charging a higher rate of ~~ee~~ corporation tax from foreign companies is that the dividends going to foreign share-holders are not considered as income arising in India; and on account of this fact the public exchequer has to lose ~~loose~~ super tax, otherwise chargeable, on ~~the income to~~ these dividends. The higher rate of corporation tax on foreign companies is levied with the intention of recovering this loss.

The Finance Act, 1956 introduced another rebate in order to check the tendency of declaring excessive dividends and the issue of bonus shares. With this object a higher rate of

super tax or the corporation tax was fixed for all companies and appropriate rebates were given to companies which did not distribute dividends in excess of the prescribed percentage, or did not issue bonus shares. This rebate was previously given in income tax and from 1956-57, it was given in the corporation tax.

The rate of corporation tax in 1955-56 was 4 annas 9 pies per rupee or about 30% and the two above mentioned rebates were allowed on it. In 1956-57 the rate was raised to 6 annas 9 pies per rupee or about 43% and the rebates allowed became of three types.

The total tax payable by a company in 1956-57 were 43.43%. (For companies which did not distribute more than 6% of their taxable profits). This tax consisted of 26.25% as income tax and the surcharge on it; and 17.18% as corporation tax. It has further been estimated that amount refundable to the share-holders on account of the income tax adjustments was about 10.67% of the taxable company income and thus the incidence of taxation on company income in 1956-57 came around 32.76% only.[1]

From 1957-58, corporation tax payable by companies is formerly 50%, but after allowing for various rebates and allowances the rates applicable on different companies are as follows:

	Rate of Super Tax
Indian company whose total assessable income is not more than Rs.25,000	15%
Indian company whose total assessable income is more than Rs.25,000	20%
Foreign company	30%

1. B. Dasgupta: Our plans and Our Public Finance; Page 54.

The above mentioned rates are applicable on the assess able incomes other than dividends form a subsidiary.[1] Dividends that a company receives from an Indian subsidiary is taxed at a rate of 10%.

In 1957-58 the total tax payable by companies was 51.50% of the total profit, i.e. 31.5% as income tax and the surcharge on it plus 20% as the corporation tax. According to estimates about 13.80% of the tax was given as refunds to the shareholders on account of adjustments in the income tax. Thus the total incidence of income tax on companies in that year worke around 37.70%, against 32.76% during the year 1956-57.

Rates of corporation tax on bonus issued and excessive dividends in 1957-58 were as given below:-

On bonus issues	30%
On dividends distributed in excess of 6% and less than 10% of paid up capital	10%
On dividends distributed in excess of 10% and less than 18% of paid up capital	20%
On dividends distributed in excess of 18% of paid up capital	30%

Next, in order to promote corporate and business inves ment some other concessions are given. Firstly, profits of new industrial undertakings, upto a maximum of 6% of the capital employed, is exempted, from tax, for a period of five years from the date of commencement of production. Dividends from such undertakings are also subject to this exemption. Secondly, a 25% development rebate is given for investment in the instalment of plant and machinery for business purposes. The rebate may continue upto a period of eight years if profits in the year of

1. A company, whose 50% or more of share capital is owned by its parent company, is defined as a subsidiary.

investment are insufficient. Thirdly, additional depreciation allowances, equal to normal onces, are allowed in respect of all investments in plant machinery, and buildings for the first five years after the investment concerned.

It can be seen that the rules regarding the taxation of company profits in India are sufficiently complicated and subject to too many loopholes. The fact that company profits are taxed at a lower rates as compared to personal incomes, leads to the practice of tax evasion by many individuals of the rich class. Rich individuals form a company, only in order to avoid higher rate of income taxation. Such private companies, the so-called 23A companies, are numerous. Most of these companies are owned by very few persons. According to the estimates given by the Taxation Enquiry Commission, in 1953, 86% of such companies were controlled by four or less than four persons; about 30% of such companies were owned by only one person. Thus, the practice of forming such companies or the so called closely held corporations leads to tax evasion. Share-holders or the owners of such companies keep much of their profits undistributed to avoid personal income taxation. Though there are separate rules governing the taxation of such companies, yet such a scheme makes the tax system all the more complicated.

In the words of Mr. Nicholas Kaldor, company taxation provision in India is "a perfect maze of unnecessary complicatio

The division of companies into different types of companies and then making for various concessions and rebates, makes the tax system extremely complicated. This indicates an absence of a clear cut policy in this respect and gives room to numerous loopholes for tax evasions.

1. Indian Tax Reform: Nicholas Kaldor; Page 85.

So far as exemptions and rebates are concerned the rules do not contain any provision for providing greater encoura ment to the industries of national importance. Development rebat as applicable to all types of business undertakings, encourage those productions too which may be of least importance to the nation.

In the cause of country's economic development during the two Plan periods, changes in respect of company taxation hav contributed very little but for the last two years. The followin table gives the revenue figures for corporation tax from 1950-51 to 1960-61 -

Year	Rs. Crores	5 yearly movi average
1950-51	40.49	-
1951-52	41.41	-
1952-53	43.80	38.67
1953-54	30.40	38.00
1954-55	37.33	39.95
1955-56	37.04	42.42
1956-57	51.18	47.20
1957-58	56.13	61.05
1958-59	54.33	81.14
1959-60	106.56	-
1960-61 R.E.	137.50	-

From 1957 onwards receipts, on account of the corporat tax, have showed steady and steep rise. The rise in receipt were mainly on account of increase in the rate of corporation tax, better introduction of excess dividends tax and then again a ris in the rate of corporation tax to make against the loss resultin from the abolition of wealth tax on companies. In turn, expansic of business has also been a factor.

UNION EXCISE DUTIES

In 1950-51, the year preceding India's planned development period, there were twelve articles which were subjected to Union Excise Duty. They were (1) Motor Spirit; (2) Kerosene Oil; (3) Sugar; (4) Matches; (5) Steel ingot; (6) Tyres and Tubes; (7) Tobacco; (8) Vegetable products; (9) Coffee; (10) Tea; (11) Cotton cloth and (12) Coal cess. Besides there were some miscellaneous receipts on account of Union excise duties to

The role of excise duties has mainly been to raise funds for economic development by cutting consumption, especiall that of non-essential articles. With this view rates of excise duties have been revised from time to time and new excise duties were imposed on several articles.

In 1953 excise duties on Artificial Silk, Cement, Soa and Footwear were introduced. Then in 1955-56, Woolen Fabrics, Electric Bulbs, Electric Batteries, Paper (excluding newsprint) and Paper Board; and Paints and Varnishes were subjected to exc duties. Later, Vegetable non-essential oils, refined diesel oi and Vapouring oils were also included in the list in 1956-57.

Now (1960-61), there are thirty seven (excluding miscellaneous) articles which are subjected to Union excise dut They are: (1) Motor Spirit; (2) Kerosene; (3) Sugar; (4) Matche (5) Steel Ingots; (6) Tyres and Tubes; (7) Tobacco; (8) Vegetab Products; (9) Coffee; (10) Tea; (11) Cotton Cloth; (12) Art Sil (13) Cement; (14) Footwear; (15) Soap; (16) Woolen Fabrics; (17 Electric fans; (18) Electric bulbs; (19) Electric dry batteries (20) Paper (excluding newsprint) and paper board; (21) Paints and Varnishes; (22) Vegetable non-essential oils; (23) Refined

Diesel oils and Vapourising oils; (24) Industrial fuel Oils; (25) Rayon and synthetic fibre and yarns; (26) Motor Cars; (27) Coal Cess; (28) Cess on Copra; (29) Cess on oils and oil-seeds; (30) Aluminium; (31) Cycle parts; (32) Internal Combustion Engine; (33) Electric motors; (34) Exposed Cinematograph films; (35) Tin plates; (36) Pig Iron and (37) Silk fabrics.[1]

With the imposition of excise duty on new articles fr time to time and the upgrading of the rates (in most of the case the volume of revenue from union excise duties has constantly been rising throughout the two plan period. Not only that, the share of union excise duties in total revenue has also been rising steadily.

The following table gives the revenues from Central Excise Revenues and their share in the total revenues of the Ce and the States during the planned development period -

Year	Central Excise Revenue in Crores of Rupees.	Total Revenue Centre and States in Crores of Rupees.	Percentage of Central Excise in total reven
1950-51	67.54	780.00	8.66
1951-52	85.80	907.00	9.45
1952-53	83.03	829.00	10.00
1953-54	94.98	837.00	11.35
1954-55	108.20	903.00	12.0
1955-56	145.25	1041.32	13.9
1956-57	190.43	1140.21	16.7
1957-58	273.62	1379.00	20.3
1958-59	312.94	1482.30	21.1
1959-60	360.65	1685.58	21.4
1960-61 R.E.	394.98	1839.00	21.5

1. From 1961-62 several new excise duties have come into for Articles taxed are: Furnace oil, Asphalt and Bitumen, Glycerine, Coaltar dyes and derivatives, Patent and Propr tory medicines, cosmetics and toilet preparations, Plasti Cellophene, Glass and Glassware, Chinaware and Porcelainw Silver, Zinc, Copper and Copper alloys, Wireless receivin sets, Refrigerators etc.

The importance of commodity taxation in underdeveloped countries is a matter of common consensus. On account of the fact that very little percentage of the population falls in the income tax paying group, it is not possible to raise the required amount of revenue resources, and the financial cooperation of vast masses can only be commanded through the imposition of tax on articles of consumption. With a view to finance the activities and the projects of common benefit, it seems quite reasonable to tax the common man. Besides, the process of economic development itself calls for a sacrifice from people as a whole. The huge financial requirements can only be met by relatively cutting consumption and ploughing back income increments, as far as possible. Economic development being a continuo process, the ploughing back of the rise in national income has tc become a sort of regular practice. And when efforts are directed to bestow benefits upon common people, and transfer resources frc high income group to the poor people, it is nothing but just to tax the common man who, otherwise, is expected to increase his consumption.

In normal days the purpose of excise duties mainly used to be to check and discourage the consumption and use of undesirable and luxurious articles. But in the light of the economics of development finance, its major function becomes to cut consumption, to the extent they are indispensable for human life, to raise finances for economic development and to check inflation.

Till 1925-26 there were only three items which were subjected to excise duties; they were cotton piece goods, motor spirit including power alcohol, and Kerosene oil. After that year the duty on cotton piece goods was abolished and thus, ther

remained only two items which were subject to this duty. Duty on Sugar and Matches were introduced as late as 1934-35. Tobacco was included in the list in 1941-42. Thus with the requirements of time, the duty was extended to increasing number of items. With its new role in the economics of country's development, not only that the number of articles subjected to union excise duty were increased, their rates also were subjecte to upward adjustment.

The following table gives the list of items which were affected by rise in Union Excise Duties and the items which were added to the list of excisable commodities during the years 1951-52 and 1960-61.

ITEMS ON WHICH EXCISE DUTY WAS INCREASED AND ITEMS ON WHICH NEW EXCISE DUTY WAS IMPOSED

51-52	52-53	53-54	54-55	55-56	56-57	57-58	58-59	59-60	60-6
Motor-spirit Kerosene			Cotton-cloth Art silk fibre	(Concession to matches) Sugar	Cotton-cloth (Tea duty reduced)	Motor spirit Matches Kerosene Tea Sugar Cement Steel ingots Tobacco Coffee Vegetable oils Paper Diesel oil	Cement (Vegetable products duty re-duced)	(Tea duty reduced) Sugar Art silk Cigarettes Refined diesel oi and vapouring oil Motor vehicle tyres	
				NEW DUTIES					
			Cement Soap Footwear	Woolen fabrics Electric fans Electric bulbs Paper except news print Paper board Paints and varnishes	Vegetable non-essential oils			Rayon and staple fibre	Cycle pa. Aluminiu Silk fib Internal combust engines Electric motors Exposed cinemat graph films Tin plat

REVENUE FROM UNION EXCISE DUTIES FROM DIFFERENT ARTICLES OVER THE TWO PLAN PERIOD

RUPEES LAKHS.

Commodity	1950-51	1955-56	1956-57	1957-58	1958-59	1959-60	1960-61 (R.E.)
Motor Spirit	208	2305	2523	3085	3252	3540	3875
Kerosene	28	243	329	306	415	681	765
Sugar	646	1858	2088	4275	5227	5000	4540
Matches	807	1008	1005	1508	1921	1796	1780
Steel ingots	54	69	64	625	728	1034	1220
Tyres and tubes	404	553	615	387	716	1044	1250
Tobacco	3199	3643	3843	4549	4909	5089	4810
Vegetable products	219	382	435	392	386	549	500
Coffee	117	93	120	132	134	146	135
Tea	336	317	319	386	471	~~474~~ 774	765
Cotton cloth	926	2818	5186	6460	5740	4675	3785
Art Silk		218	103	169	196	207	189
Cement		222	255	1117	1391	1676	1750
Footwear		84	99	97	105	116	150
Soap		155	185	176	223	210	205
Woollen fabrics		53	61	61	86	75	62
Electric Fans		27	32	46	53	72	110
Electric bulbs		25	28	30	33	40	70

(CONTINUED)

CONTINUED

Commodity	1950-51	1955-56	1956-57	Rupees Lakhs 1957-58	1958-59	1959-60	1960-61 (R.E.)
Electric Batteries		73	89	80	[illegible]	[illegible]	170
Paper		268	327	539	678	797	825
Paints and Varnishes		101	117	120	127	137	140
Vegetable Non-Essential Oils		29	530	980	1002	1335	1225
Refined Diesel Oils and Vapourising Oils		16	253	701	960	2450	3800
Industrial Fuel Oils		47	303	324	477	1191	950
Rayon and Synthetic fibres and Yarn		Negligible	7	29	86	202	270
Motor cars		Negligible	5	32	20	63	950
Coal Cess	162	238	218	268	325	316	375
Cess on Copra		Negligible	Negligible	12	13	10	10
Cess on Oils and Oil Seeds		Negligible	15	91	41	54	25
Miscellaneous	44	76	121	474	173	512	1178
Total Union Excise Duties	6754	14525	19043	27362	31294	36065	39498

Source: Reserve Bank of India; Currency and Finance Report for 1958-59 Statement 56

Before the advent of planned economic development in India, Custom duties formed a substantial part of public revenues In 1950-51 Customs fetched Rs.155.06 Crores, which constituted about 20% of the total Central and States' revenues. This sum accounted for Rs.107.70 crores as import duties and Rs.47.36 Crores as export duties.[1] But with the increasing restrictions on imports and exports, in order to encourage domestic enterprise and to use the maximum available foreign exchange for securing the capital requirements of development, customs lost their importance. In 1959-60, customs accounted for Rs.156.1 (a/c) Crores only; Rs.~~114~~ 135.92 Crores representing the import duties and Rs.~~16.95~~ 14.89 for the export duties. The share of customs declined to about 9.5% in the total Central and States revenues. The place of customs has gradually been taken up by the Central Excise duties. The estimates of 1960-61 (revised) put the Union Excise Revenue at Rs.394.98 Crores that represents about 22 percent of the total public revenue in India.

There are three basic functions of commodity taxation in a developing underdeveloped country. Firstly, it has to be resorted to raise revenue for economic development. For this, it should be such, that it reaches the population and covers all that class of people whose taxation, through direct taxes, is not possible on account of administrative difficulties, as their incomes fall below the tax exemption limit or they stay out of the monetised sector. In the light of this function, taxes on cloth, kerosene, sugar, matches etc. are justified. Then to make this tax of an equitable nature, it becomes necessary to tax articles of necessity at lower rates and that of luxury, at high rates. On these grounds, low tax rates on coarse or rough cloth

is justified against comparatively high rates on fine and superfine clothes, and the like.

The second function of commodity taxation is to cut mass consumption and release resources for investment on development. The statement neither needs justification nor elaboration that necessary articles, in view of physical and mental development of people, should be spared from this taxation. Articles of secondary category, which are not necessary for life should be subjected to tax, with this view. Tobacco, footwear, betalnuts, paints and varnishes etc. are articles which are of customary use and without which one can very easily live.

Its third function is to combat inflation. With this view excise duty should be imposed on articles, which are expect to come in immediate demand as a result of increasing incomes of the people of lower income group. It can be thought that rise in income of the lower income class, next to food articles, will give rise to the demand of articles like soap, cosmatics, glassware, tooth pastes, brushes, electric fans, wristwatches etc. Taxes on these articles and the like help perform this function of commodity ta xation.

Examination of the tax.

Among the excisable commodities the largest single revenue contributer is cotton cloth. Rs.64.60 crores were raise as excise duty on cotton cloth in 1957-58 against a sum of Rs.9. crores in 1950-51. This revenue increased by about 7 times within a period of eight years.

Largest excise duty contributor commodity in 1950-51 was tobacco. Sum raised on this account was Rs.31.99 crores in that year. In 1957-58 on this account Rs.45.49 crores were rai

a half times over the eight year period.

This is simple fact that importance of clothes is far more than that of tobacco. Tobacco is customary consumable commodity. Its consumption neither adds to nourishment nor to the betterment of any other human faculty. Besides, tobacco is a profitable export commodity as well. A higher excise duty on it would not only discourage its internal consumption but will open more profitable chances for its export too. It is very strange that duty on cotton cloth has been rising at a faster rat than it increased on tobacco.

Rates of excise duty[1] on unmanufactured tobacco at th rate of Rs.2.50 per kilogram, is too low. Similar is the case of cigarettes and biris. Maximum rate applicable on cigarettes (in 1960-61) is Rs.23.75% per 1000 cigarettes on cigarettes which cost more than Rs.35 per 1000. These rates go on reducing and minimum duty is on the quality where 1000 cigarettes cost less than Rs.7.50 nP. In that case the rate applicable is Rs.1/20 per 1000 cigarettes. The quality of cigarettes is devided into eigh categories according to their prices, and duty rates increase wi the price of the cigarettes. The minimum duty (that is on the cheapest cigarette) is 12/100 nP. on one cigarette and the maximum (that is on the costliest cigarette) is about 2.4 nP. per cigarette.

The duty on cigarette, an absolutely non-essential consumption commodity, is extremely low. Besides, their divisi into eight categories (a number greater than the number of sla for income tax purpose) is wasteful. Similar is the case with

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1. Rates mentioned hereafter, correspond to 'The Central Exci (Conversion to meteric units) Bill 1960, (with corrections supplied by courtesy of the Office of the Collector of

biris. Biri is a thing that is smoked by a very large number of population. The cause of smoking is only habit. Boys from their very childhood develop the habit of smoking because it is easily within their reach on account of its very low price. It is very necessary to tax this non-essential consumption article at a far higher rate.

Coming back to the duty on cotton cloth, it is interesting to note that fine and superfine cotton fabrics are taxed at one single rate; and medium and coarse fabrics are taxed at another one single rate. Thus, for taxation purposes all types of cotton fabrics ranging from, say Re. one per metre to Rs. ten per metre are classified only into two categories (This again reminds of classifying cigarettes into 8 categories). A poor man would have to pay 30 NP. as tax for his necessity while a very rich man will pay only 45 nP. for his luxury. The differentiation is quite opposed to the laws of equity and with the aim of cutting consumption too, medium, fine and superfine clothes deserve a higher rate of duty.

Duty on Art Silk and rayon fabrics at the rate of 7 per square metre is extremely low. It is true that these infant domestic industries deserve encouragement but their worth is certainly secondary to the worth of coarse cotton cloth, which an essential requirement for a very large percentage of the country's population.

Sugar has, during the planned development period, acquired sufficient importance in view of obtaining revenue from union excise duty. Its share has risen from Rs.6.46 crores in 1950-51 to Rs.42.75 crores in 1957-58. Part of this increase is due to rapid rise in the production of sugar during the period

... in 1950-51 to 1860

thousand tons in 1955-56,[1] and to 2446 thousand tons in 1959-60 (production year)[2]. The second reason of rising volumes of receipts from duty on sugar was the increasing rate of duty on it

With the rising incomes of the individuals of lower income group, as can easily be understood, the demand for sugar increased at a rate greater than the rate of its supply, and it become necessary to raise its duty. Besides, rising duty on sugar is justified with the view that sugar is mostly used for conventional necessities. In order to restrict consumption, whi is the foremost pre-requisite of economic development, duty on sugar becomes unavoidable.

In 1959, the rise of excise duty on Khandsari sugar attracted great controversies but the present duty on Khandsari sugar at the rate of Rs.11 per quintal,[3] against a duty of Rs.22.1 per quintal on crystal sugar is not unjust. Khandsari sugar is used mostly in villages, where the population escapes many of t taxes on account of the fact that they exist in a non-monetised sector.

Duty on motor spirit, rising from Rs.2.08 crores in 1950-51 to Rs.30.85 crores in 1957-58, has become a very import source of revenue. In order to ensure a better utilisation of this scarcely produced commodity, it is necessary to impose a high duty on it. But the only trouble with this is that its u is also made for transportation purposes. When essential good are transported from one place to another, say on trucks, duty on motor spirit is shifted to the consumers of the transported

1. Review of the First Five Year Plan: Page 16.
2. Statistical Outline of India 1961, Tata Industries Pvt.L and India 1960; Page 310.
3. One Quintal = One Hundred Kilograms.

goods. If a device can be found outto ensure that certain amoun of motor spirit is being used for a given purpose only, it would be more equitable and just to tax motor spirit, which is used fo transporting essential goods etc, at a lower rate; and motor spirit used for other non-essential purposes at a higher rate.

Union Excise duty on matches is another important ite Till 1950-51 it constituted a large share in the total revenues from the excise, but now it has lost its relative importance. I share has declined from about 12% in 1950-51 to about 5.5% in 1957-58. Matches are used in fairly large number all over the country. Masses can be reached and conveniently tackled by duty on matches. At the end of the Second Plan the rate of duty on it was 65 nP. per 1,000 matches. This rate is sufficiently low, especially in view of the fact that in underdeveloped countries like India, a very large percentage of people escape direct taxation, and not only that they escape most of the commodity taxes. It is only through such taxes that mass consumption can be kept into some degree of control.

In place of concession in match excise on medium and cottage factory made matches, it would have been better to introduce the favourable discrimination towards cottage industry by keeping their rate at its then existing level and increase th excise duty rate on matches made by other factories. This step would not only have helped in raising the volume of revenue during the year 1955, but it would have also kept a check on inflation, which during the following years caused continuing anexity and raised the cost of the Second Plan.

Kerosene and Others.

Receipts from excise duty on Kerosene, during the yea 1950-51 amounted to Rs.28 lakhs and till 1957-58 it had risen to

Rs.306 lakhs. The rate of duty on Kerosene was raised in 1951-52 by 5% and since then no effective change in it was introduced. Kerosene oil is a necessity to the lower middle class people and hence the maintenance of rates on it can amply be justified.

Among other excisable articles since 1950 are Tyres and tubes, Vegetable products, coffee and tea. Receipts in respect of duties on these articles have not shown any marked improvement over the two Plan period. It is strange that tea and coffee have been neglected in order to raise the public revenue and check mass consumption. Especially tea is widely consumed item and on the other hand it can profitably be used to earn foreign exchange. Receipts from duty on tea were Rs.3.36 crores in 1950-51, Rs.3.17 crores in ~~1956~~ 1955-56, Rs.3.19 in 1956-57 and Rs.3.86 crores in 1957-58. Sparing tea, specially in the light of steeply rising sugar excises during the above mentioned period, is quite surprising.

The New Excises.

The new items which were subjected to excise duty during the first two plans' period are Cement, Soap, Footwear, Woolen Fabrics, Electric Fans, Electric Bulbs, Electric Batteries, Paper (excluding Newsprint), Paper Board, Paints and Varnishes, Vegetable Non-Essential Oils, Rayon and Staple Fibre, Motor Cars, Aluminium, Cycle Parts, Internal Combustion Engines, Electric Motors, Exposed Cinematographs films, Tin Plates, Pig Iron, Silk Fibre etc.

Among the new excise duties, refined Deisel Oils and Vapouring Oils constitute the largest share and receipts on this account ~~has~~ have shown maximum rise too. Receipts from excise duty on refined diesel oils and vapouring oils were Rs-16 lakhs in 1955-56

and the yield was expected to go up to Rs.1,725 lakhs in 1959-60. Next to it, is Cement; where the rise was expected from Rs.222 lakhs in 1955-56 to Rs.1,403 lakhs in 1959-60. Rise in the receipts from excise duty on vegetable non-essential oils has also been of a remarkable degree. It rose from Rs.29 lakhs in 1955-56 to Rs.1,320 lakhs in 1959-60.

Among the new excises, footwear and motor cars provide an excellent example of the tax policy. Footwear is a necessity and it is used by all except very poor people. Against it, motor car is a luxury and that can only be enjoyed by very few people who can afford to invest a large sum for its purchase and high recurring maintenance expenditure.

Present rate of excise duty on footwear is ten percent ad valorem. Compared to this, duty on motor vehicles is very low.

Excise duty on motor cycles, scooters,autocycles and other three wheeled vehicles is charged at one single rate, i.e. Rs.175 each. The average cost of such articles may be put at Rs.2,000. Now Rs.175 on a luxury thing of such a high value that is something about 9% ad valorem is very low.

Now for duty purposes motor vehicles have been divided into two categories. Motor vehicles of 16 Horse Power and below, are charged at the rate of Rs.1,000 each and motor vehicles of more than 16 Horse Power are charged at the rate of Rs.3,000 each or 15% ad valorem (whichever is greater). Rate for other than these is Rs.2,000 each or 12.5% ad valorem (whichever be greater).

The first defect in motor vehicle duty is that it does not differentiate between the purpose of its production. Some motor vehicles are produced in order to develop transport facilities in the country and others for private luxury purposes. The claim of transport motor vehicles is naturally superior to

that of the other types.

Secondly, the rate of duty on it is surprisingly low. A motor car, (of less than 16 H.P.) or the like is liable to cost something between Rs.10,000 to Rs.60,000 or even more. Thus a duty of Rs.1,000 on it that is, less than 10% ad valorem is quite unjust. It is wrong also with the point of view that whether the car costs Rs.10,000 or 60,000, duty on it is same i.e. Rs.1,000. This is neither equitable nor as much as it should be.

Receipts on account of duty on footwear rose from Rs.84 lakh in 1955-56 to Rs.105 lakhs in 1959-60 (estimated). The rise is very little and serves to show that inspite of over 4 crore rise in population and rise of per capita income during that period the consumption of footwears has not increased to any appreciable extent. On the other hand collections on account of duty on motor cars has risen from nil (or negligible) in 1955-56 to Rs.~~23~~ 950 lakhs (estimated) in 1960-61 ~~1959-60~~. The rise points out~~wards~~ towards the accumulating money in the hands of richer section of the community and the rising demand for motor vehicles.

Duty on art silk is another item which has comparatively been neglected to a considerable extent. The rate of duty on it is 7 nP. per square metre as compared to 30 nP. to 45 nP. on cotton fabrics.

Other than these there are several items which were added from time to time for union excise taxation, but the yield through them has been sufficiently low. In a nutshell it may be said that though the volume of receipts from union excise duties, as a whole, has constantly and appreciably been rising but its distribution among different items has neither been equitable nor conducive to the atmosphere of savings. Besides, it is surprising that at a time of expanding the number of excisable commodities

refrigerators, radios, cosmatics, silk, silver, precious-metals, glassware, chinaware, air conditioning machines etc. (many of which have been included after 1960-61) were spared and several other items of considerably lesser importance were included.

ANNUAL TAX ON WEALTH

As it has already been explained in the foregoing pages that whatever little amount an underdeveloped country saves, a great part of it is spent for the accumulation of personal wealth. Non-economic savings such as cash hoarding, construction of luxurious buildings, purchase of precious stones and ornaments, purchase of land for the sake of social prestige etc. is a matter of common practice among those limited number of people of underdeveloped countries who possess some propensity to save.

The attempt of the fiscal system of a developing country, in this connection, is naturally to discourage these sort of savings in future and to tax the accumulated wealth, so that private wealth accumulation may become costlier for the owners and they may release it to be used in the interest of country's development.[1]

The Cambridge University economist, Mr. Kaldor also suggested a tax on wealth of the people. He suggested the wealth tax, along with the income and super tax, on grounds of equity and as a measure to increase the volume of public revenue. As regards the question of equity, he was of the opinion that an individual's capacity to pay taxes does not only depend on his current income - it also depends on his other permanent economic assets.[2]

The wealth tax was introduced, for the first time in the Indian fiscal history with the 1957-58 budget. It proposed to

1. This view has been endorsed by the United Nations' experts.
2. N. Kaldor: Indian Tax Reform.

levy a tax on the net wealth, above the exempted level, of individuals, joint Hindu families and companies. Properties which were exempted from this tax were, agricultural properties, properties belonging to religious and charitable trusts, animals, works of arts, books, household effects (upto a maximum of Rs. 25,000), investment in certain Government securities, the balance of the provident funds and life insurance policies, shares of the new industrial companies etc.

Companies relating to Banking, Insurance and shipping were totally exempted from this tax. Besides, new industrial companies were to get exemption from wealth tax for a period of five years after the date of their establishment.

The basic exemption limit of wealth was Rs. 2 lakhs in case of individuals, Rs. 4 lakhs in case of joint Hindu families and Rs. 5 lakhs in case of every company. The rate of wealth tax was initially as follows :-

In case of every individual :

On the first rupees two lakhs of net wealth	Nil
On the next rupees ten lakhs of net wealth	.5%
On the next rupees ten lakhs of net wealth	1.0%
On the balance of net wealth	1.5%

In case of every Hindu undivided family :

On the first Rs.4 lakhs of net wealth	Nil
On the next Rs.9 lakhs of net wealth	0.5%
On the next Rs.10 lakhs of net wealth	1.0%
On the balance of net wealth	1.5%

In case of every Company :

On the first Rs.5 lakhs of net wealth	Nil
On the balance of net wealth	0.5%

At the time of introduction of the wealth tax in 1957, it was estimated that it would affect about 26,000 individuals, 4,000 Hindu undivided families and 6,000 Companies.[1] It was also estimated that a sum of Rs.12.5 crores would be raised by this tax in 1957-58.

The introduction of annual wealth tax is beyond doubt an effective and a desirable measure in view of discouraging uneconomic savings. But in view of India's present needs and its deep rooted conventions, an exemption of personal wealth of Rs.2 lakhs for an individual seems to be too high. The tax free slab as suggested by Mr. Kaldor was of Rs.1 lakh[2], and the suggestion was quite reasonable. The second thing he suggested was that maximum rate of tax should apply on the portion of wealth above Rs.15 lakhs, while according to the actually adopted rates, the maximum rate applies on incomes above Rs.22 lakhs. The upper limit also seems to be too high.

According to Mr. Kaldor "for the sake of equity, as well as administrative efficiency, it is essential that the tax should be comprehensive, i.e. extending to all forms of property. The inclusion of agricultural property in this connection may require a constitutional amendment, ... Property in the form of bank balances, jewel and valuables above a certain limit, say, Rs.5,000 as well as real estate of all kinds, assignable rights with a marked value, the ownership of stocks and shares etc. should all be comprised in it."[3] But in connection with this tax too, many exemptions have been granted. It has been accepted by common

1. Budget 1957-58: Taxation Measures Explained.
2. N. Kaldor: Indian Tax Reform; Page 19.
3. N. Kaldor: Indian Tax Reform; Pages 19-20.

consensus that chances of evasions and avoidances increase with the number of exemptions, abatements and other provisions.

Some changes in wealth tax were introduced by the Finance Act of 1959. These related to "increase in the rate of wealth tax payable by individuals and Hindu undivided families by a ½% at each slab."[1] Thus the new rates in respect of individuals became as given below:

In case of individuals:

On the first rupees two lakhs of net wealth	Nil
On the next rupees ten lakhs of net wealth	1 per cent.
On the next rupees ten lakhs of net wealth	1.5 per cent.
On the balance of net wealth	2 per cent.

and in case of every Hindu undivided family:

On the first Rs.4 lakhs of net wealth	Nil
On the next Rs.9 lakhs of net wealth	1%
On the next Rs.10 lakhs of net wealth	1.5%
On the balance of net wealth	2%

The wealth tax on companies was abolished the same year and the over all rate of Company and the Corporation tax was increased accordingly, to compensate for the loss of revenue in thi respect. The changes in respect of wealth tax on individuals and Hindu undivided families was expected to yield Rs.2.5 crores.

The revenue on account of wealth tax has been as follows:[2]

Year	Rs.Crores
1957-58	7.04
1958-59	9.67
1959-60	12.11
1960-61 B.E.	7.00
1960-61 R.E.	7.50

1. Currency and Finance Report; 1958-59: Reserve Bank of India; Page 61.
2. Reserve Bank of India: Currency and Finance Report, 1960-61: Statement 57.

The loss in the wealth tax revenue in 1960-61 and the following years was on account of the fact that the wealth tax on companies was dropped out by the Finance Act of 1959 and thus loss of revenue from tax on wealth was reflected in the following years.

The wealth tax has proved its usefulness by yielding notable amount of revenue, and its equitable character. As compared to income, it is easier to assess wealth and thus this tax contains lesser chances for evasions. It does not cause much strain upon the administrative efficiency and is easy to collect.

With the point of view of equity too, wealth along with the income of the assessee, forms a more equitable tax base as compared to the consideration where only current income is deemed to be the measure of one's taxable capacity. The reason, as correctly given by Mr. Nicholas Kaldor, is "that the ownership of property in the form of disposable assets endows the property owner with a taxable capacity as such, quite apart from the money income which that property yields.[1]"

In view of the economic effect of the wealth tax, it is nothing but desirable for financing the planned development of an underdeveloped country.

1. N. Kaldor: Indian Tax Reform; Page 20.

THE EXPENDITURE TAX

The Expenditure Tax is one of the taxes which have been introduced on the recommendation of the Cambridge University economist, Mr. Kaldor. It was introduced with the 1957-58 budget and came into force from April 1, 1958.

The tax is payable on taxable expenditures incurred by individuals and joint Hindu families. It is levied in respect of expenditure incurred during the preceding financial year. The tax is levied in case of individuals and joint Hindu families whose spendable income (income left after the payment of all direct taxes i.e. income tax, super tax, the surcharges, wealth tax etc. but not the expenditure tax) exceeds Rs.36,000.

Many expenditures are deductable in order to arrive at the taxable expenditure. Savings, investments, expenditures for business purposes, expenditures for acquiring, constructing or repairing immovable property, repayment of loans, gifts etc. are excluded from the taxable expenditures.

From the total non-exempt expenditure several abatements are admissible which mainly include a standard or basic allowance of Rs.30,000, and an additional allowance of Rs.3,000 per additional member of the joint Hindu family. A marriage abatement upto a maximum of Rs.5,000 is allowed for the marriage of each dependent. Besides, parents' maintenance allowance upto a maximum of Rs.4,000, medical expenses allowance upto a maximum of Rs.5,000, foreign education expenses of dependents upto a maximum of Rs.8,000 etc. are allowed.

After allowing for the above mentioned exemptions and abatements the taxable expenditure is arrived at, and the expen-

family) at the following rates -

1. Taxable expenditure which does not exceed Rs.10,000	10%
2. Taxable expenditure which exceeds Rs.10,000 but does not exceed Rs.20,000	20%
3. which exceeds Rs.20,000 but does not exceed Rs.30,000	40%
4. which exceeds Rs.30,000 but does not exceed Rs.40,000	60%
5. which exceeds Rs.40,000 but does not exceed Rs.50,000	80%
6. which exceeds Rs.50,000	100%

Taxable expenditures include, besides the expenses of the actual income earner, the expenditures incurred by other persons on his behalf e.g., by his wife, children, dependents etc. Expenditure for certain durable consumer commodities such as motor cars, furniture, etc. is equally distributed over a period of five years (one, the year in which the expenditure has been incurred and the four succeeding years) in order to compute the taxable expenditure.

It was estimated that about 6,000 persons would be affected by this tax.

The expenditure tax was introduced with two main intentions - firstly to discourage heavy expenditures by the wealthy class and encourage savings; and secondly with a view to bring revenues to the public exchequer.

At the time of introduction of this tax it was estimated that it would bring Rs.3 crores during the year 1958-59.[1] But it did not prove as fruitful a tax, as it was supposed to be

1. Central Government Budget, 1958-59.

Revenues on account of this tax have been as given below:[1]

Year.	Rs.Crores.
1958-59 (Budget)	3.10
1958-59 (Revised)	1.00
1958-59 (Actual)	0.64
1959-60 (Budget)	1.00
1959-60 (Revised)	0.80
1959-60 (Actual)	0.79
1960-61 (Budget)	0.90
1960-61 (Revised)	0.90
1961-62 (Budget)	0.80

It is clear from the receipts on account of the expenditure tax that it, at least in its present form, has miserably failed. The receipts, even during the following three years, have amounted far below Rs.1 crore against the target of Rs.3 crores in the very first year.

The suggestion for introducing an expenditure tax in India was mainly based on Mr. Kaldor's arguments, given in one of his earlier work, 'An Expenditure Tax', which were developed in an un-Indian background. His stay in (and therefore his knowledge about) India was extremely short and it was, to a great extent, incorrect to apply the principles developed into one type of circumstances, to some entirely different circumstances.

The income tax staff in India is ill-trained and ill equipped even to deal with the income tax cases. Many income tax cases in connection with the past years are still pending. Besides the practice of large, widespread tax evasions in India, is still

1. All figures relate to Reserve Bank of India's Currency and Finance Report for 1960-61; Statement 57.

quite common. Under such circumstances, the introduction of an expenditure tax, with its several exemptions and abatements, seems quite untimely.

As it has also been accepted by Mr. Kaldor himself that a tax should be imposed in view of the administrative efficiency too[1]; this tax is not suitable. Again, he has also expressed that a progressive tax on expenditure is liable to raise many administrative difficulties and, therefore, he himself has not approved it as a measure for mass taxation. It, then seems quite strange that how such a tax could be found useful for an underdeveloped country with a sufficient degree of slack administration.

So far as the savings encouraging nature of the expenditure tax is concerned, it is true that it does discourage expenditure and thus encourages to save; but it does not discriminate in the types of savings. It may very well encourage uneconomic savings such as cash hoarding. It is very well known that uneconomic saving is one of the major problems in an underdeveloped country. Mere encouragement to savings is not sufficient - what is needed is the maximum flow of savings into the desired channels.

Another defect of the expenditure tax is that it covers a very limited number of individuals. The number of individuals covered by the expenditure tax was originally estimated around six thousand, which represents hardly .14% of India's population. On account of the ineffectiveness of this tax to deal with the masses, the basic expenditure tax exemption level was placed at Rs.30,000. For being left with Rs.30,000 to spend after paying the income tax and super tax, one's pre-tax income

should be of the order of Rs.66,000[1] or more. This high level has considerably reduced the number of cases which could be affected by this tax.

Mr. Kaldor had suggested that there should be an exemption of expenditure upto Rs.10,000 per adult and above that the expenditure should be taxed according to the slab system of graduation, starting from 25% on the lowest slab and rising gradually to a maximum of 300% on expenditures in excess of Rs.50,000 per adult. He further assumed that one family was comprised of three adults and thus, according to this scheme a family expenditure of Rs.30,000 would be exempted from taxation.[2] The expenditure tax, as actually adopted in India, also provides for an exemption of Rs.30,000 and as it has already been mentioned, it was expected to affect something around 6,000 persons only.

Next, the expenditure tax provides for too many exemptions and abatements. If one family be assumed to consist six members, the basic exemption limit of Rs.30,000 means an expenditure exemption of Rs.5,000 per head. This level itself, as compared to India's per capita income of less than Rs.300, is too high to be exempted. Besides, there are provisions for parents' allowance of Rs.4,000, foreign education allowance upto a maximum of Rs.8,000, medical allowance upto a maximum of Rs.5,000 allowance for the marriage of each dependent upto a maximum of Rs.5,000 etc. These all expenditures are exempted from taxation. Even more, heavy expenditures on durable consumer goods are spread over a period of five years, to reduce the immediate tax liability of the assessees. All these provisions hardly leave any room for the expenditure tax to be excercised, and its expenditure discouraging effect remains negligible and moreover,

it is liable, to increase the number of tax evasions.

The expenditure tax does not actually tax the spending power of an individual it only taxes that part of one's spending power that one excercises. Therefore, in true sense it is not a tax according to an individual's taxable capacity.

In underdeveloped countries a very large part of population is comprised of illiterate persons and as a general practice, they do not keep any account of their income and expenditures. Their income can possibly be accounted, as generally the source or the sources of income are not too many, but it is spent in several ways. People of an underdeveloped country, also of India, would at least take a generation to get into a practice of maintaining accounts. Under such circumstances, if they are forced to produce the account of their expenditures, their accounts will be far from being reliable.

A tax can be justified on grounds of administrative efficiency, equity and favourable economic effects. This view has been endorsed by Mr. Nicholas Kaldor too. But, as we have already seen, the expenditure tax fails to justify its existence on any of the above mentioned grounds, especially in an underdeveloped country like India. It gives rise to innumerable administrative difficulties. It only taxes the exercised spending power and, therefore, it is not a tax according to ones taxable capacity. Finally in its economic effects, it carries with it chances for increasing tax evasions and it may very well encourage cash hoarding.

For all practical purposes, the expenditure tax has proved useless in India. The yields on this account have remained far below Rs.1 crore and there is no doubt that its

administration must have consumed much energy of the staff and the cost of its collection must have been too high. As regards the encouragement to savings, it is futile to think that such an indirect inducement to savings would be of any help in an underdeveloped country. Only a positive charm or positive compulsion can bring savings into economically useful forms and it is clear that the expenditure tax does not provide any inducement to encourage economically useful savings.

In view of all these considerations the introduction of expenditure tax has been untimely and a trouble worth nothing.[1]

1. The Expenditure Tax has been abolished from 1st April, 62.

ESTATE DUTY AND THE GIFT TAX

With a view to reduce inequality of economic resources among the people the Estate Duty Act was passed in the year 1953. It imposed a tax on the property left by an individual after his death.

The Union Government imposes a tax on the net non-agricultural property passed or deemed to pass on the death of a person. Twelve States have also authorised the Union Government to levy estate duty on agricultural properties situated in their States, but revenue collected from agricultural property located in the twelve States is returned to them on the basis of collections made in each State. The rest of the revenue - arising from the estate duty in respect of non-agricultural properties is distributed between the Centre and the States according to the recommendation of the Finance Commission.

For purpose of taxation, all property passing on the death of a person is aggregated to form one estate and its market value is computed. Originally the exemption limit in respect of estate duty was Rs.1 lakh, but later in 1958, the limit was reduced to Rs.50,000.

Portion of the estate above the exemption level is taxed at progressive rates as follows:[1]

1. India 1960: Page 540-41.

(a). In the case of property which consists of an interest in the joint family property of a Hindu family governed by the Mitakshara, Marumakattayam or Aliyasanatana Law:

		Rate of duty
1.	On the first Rs.50,000 of the principal value of the estate	Nil
2.	On the next Rs.50,000	5.0%
3.	On the next Rs.50,000	7.5%
4.	On the next Rs. 50,000	10.0%
5.	On the next Rs.100,000	12.5%
6.	On the next Rs.200,000	15%
7.	On the next Rs.500,000	20%
8.	On the next Rs.10,00,000	25%
9.	On the next Rs.10,00,000	30%
10.	On the next Rs.20,00,000	35%
11.	On the balance of the principal rate of the estate	40%

(b). In case of property of any other kind.

		Rate of duty
1.	On the first Rs.1,00,000 of the principal value of the estate	Nil
2.	On the next Rs.50,000	7.5%
3.	On the next Rs.50,000	10.0%
4.	On the next Rs.1,00,000	12.5%
5.	On the next Rs.2,00,000	15%
6.	On the next Rs.5,00,000	20%
7.	On the next Rs.10,00,000	25%
8.	On the next Rs.10,00,000	30%
9.	On the next Rs.20,00,000	35%
10.	On the balance of the principal value of the estate	40%

Revenue from the estate duty has been as follows:[1]

Year	Rupees (Crores)	Year	Rupees (Crores)
1954-55	0.81	1958-59	2.70
1955-56	1.81	1959-60	2.91
1956-57	2.11	1960-61 Revised	3.00
1957-58	2.31		

As it is quite clear from the receipts on account of the estate duty, this tax has not proved fruitful with the point of view of raising revenue for the public exchequer. Revenue from this source did not exceed Rs.3 crores. But with the point of view of equity this tax justifies its existence. In the absence of equality, liberty has practically no meaning. The justification for a death tax or tax on the inheritance of a property is "that the community has the right to limit each individual's freedom to pass on his property intact to his successors".[2] Besides, inheritance of a property gives the individual an additional taxable capacity besides his own capacity to pay the taxes. The case might be argued in one more way. If estates are passed to the successors without any tax, it might cause a loss of incentive in the inheritor and thus, would reflect into a loss to the community. Further, the tax on the inherited property can be paid off by the sale of a part of the inherited asset; it does not cause any burden on the tax payer - it only reduces the magnitude of the inherited asset.

One of the reasons for the estate duty being not very productive is, that in order to avoid the tax or to reduce its liability a gradual transferrence of the property has been

1. Reserve Bank of India: Currency and Finance Report, 1955-56, Statement 58 and 1960-61, Statement 57.

practiced. As Prof. Kaldor has explained, "the attempt to give away a part of one's estate with a view to reducing the liability to estate duty is particularly strong when taxes are levied on progressive scale, since in that case tax is saved not only through a portion of the estate being passed on inter viros, but also through a lower rate of duty being applicable to the remainder"[1].

To improve upon this desirable mode of promoting social equity Mr. Kaldor suggested the imposition of a "single integrated tax on gifts of all kinds (including under this term accession to property through bequest and inheritance) which should replace the present estate duty, as well as bring into charge other gratuitious transfers of property which are not now (in 1956) taxable."[2]

Another reason for tax on gifts is that the imposition of estate duty develops a desire in the property owner to transfer his property to his heirs and successors before his death, to avoid the tax; and avoidance of this nature can be reduced by discouraging such gifts.

The proposal of Mr. Kaldor was to levy a uniform tax on all gratuitous transfers, irrespective of whether the transfers were made inter viros or by way of legacy or bequest.[3]

His another important suggestion was to place the liability of the tax on the donee (and not the donor). He has stated that "the ideal method appears to be to make the rate of taxation dependent neither on the size of the gift nor on the wealth of the donor but on the total wealth of the receipient i.e. his net worth including the gift."

1. N. Kaldor; Indian Tax Reform; Page 49.

The gift tax rates suggested by him were that there should be an exemption limit of Rs.10,000 for any single recipient and that gifts over and above this should be taxed at the rate 10% if the net wealth of the recipient is below Rs.1 lakh, and .... 15% between Rs.1 lakh and Rs.1.5 lakh, 20% between Rs.1.5 lakh and 2 lakhs, 25% between Rs.2 lakhs and Rs.3 lakhs and so on, the rate becoming 30% if the total estate of the donee[1] exceeds Rs.20 lakhs."[2] Mr. Kaldor, on the basis of his studies and estimates, further claimed that the probable yield of the gift tax as suggested by him would be around Rs.30 crores,[3] in a year.

The Gift Tax was introduced in 1958, but it was not introduced as a 'single integrated tax', as recommended by Mr. Kaldor; it was introduced to supplement the then existing estate duty as it is charged in U.S.A., U.K., Australia etc. The tax is on all gifts made by individuals, Hindu undivided families, Companies, Firms and other association of persons except charitable institutions, Government companies and public companies. Certain gifts are exempted from the tax. For example gifts of savings certificates which have been declared gift tax free, gifts to female dependents on the occasion of their marriage (upto a maximum of Rs.10,000), gifts of wife (upto a maximum of Rs.1 lakh), and gifts made under will, are exempted from tax.

Excluding the exempted gifts, a gift tax is charged if the total value of gifts made by donor exceed Rs.10,000 in a year. The rates of gift tax as they were actually adopted are as given below:[4]

1. Including the gift that he receives.
2. N. Kaldor: Indian Tax Reform; Page 51.
3. Ibid.
4. India 1960: Page 542

			Rate of Tax
1.	On the first Rs.50,000 of the value of all taxable gifts		4%
2.	On the next Rs.50,000	-do-	6%
3.	On the next Rs.50,000	-do-	8%
4.	On the next Rs.50,000	-do-	10%
5.	On the next Rs.1,00,000	-do-	12%
6.	On the next Rs.2,00,000	-do-	15%
7.	On the next Rs.5,00,000	-do-	20%
8.	On the next Rs.10,00,000	-do-	25%
9.	On the next Rs.10,00,000	-do-	30%
10.	On the next Rs.20,00,000	-do-	35%
11.	On the balance of the value of all taxable gifts		40%

Collections from the gift tax have been as follows:[1]

1958-59	Rs.0.98 Crores.
1959-60	Rs. 0.81 "
1960-61 Revised	Rs. 0.80 "

Though the gift tax has been introduced in the Indian ~~Tax~~ tax system, but its rates are far below the rates suggested by Mr. Kaldor. As a matter of fact there is practically no comparison between the two. Against the 10% tax on the lowest slab suggested by Mr. Kaldor, the actual tax on it is only 4%. On the highest slab the actual tax is only 40% against the suggested rate of 80%. Besides, the maximum rate of 40% that is made applicable to the balance of the value of gifts above Rs.50 lakhs, according to Mr. Kaldor's suggestion was 80% on the balance of the value gifts above Rs.20 lakhs. Thus, the rates are far far below the rates

1. Currency & Finance Report for 1960-61; Page 57.

suggested by Mr. Kaldor. With the point of view of revenue from gift tax, it has proved far less productive than it was estimated to be. Against the earlier estimates of Rs.2 crores in 1958-59, revenue from this source has not reached even Rs.1 crore in any year. The combined revenues from the estate duty and the gift tax have remained below Rs.4 crores, against Rs.30 crores as estimated by Mr. Kaldor (provided the tax was charged at a rate suggested by him.)

So far as the utility of a tax on gifts is concerned, there can hardly be two opinions. It has been accepted as a necessary mode to check the possible evasions of the estate duty, which in turn is necessary in view of social equity. Now the question arises that whether the gift tax should have replaced the then existing estate duty or complimented it?

Introduction of gift tax as a separate tax along with the estate duty, prima facie, means an increase in the number of taxes and thus imposing psychological burden upon the tax payer. Secondly the taxation of gifts and the transfer of one's property in inheritance, at different rates, gives the donor a chance to choose a way where he has to pay lesser tax. Moreover there does not seem a reason to discriminate between a gift by a donor and the transfer of his property to his legal heir after his death. Transfer of both the types occur at the choice of the same individual and, therefore, a discrimination between the two, only to complicate the tax structure, seems quite unnecessary.

Next, Mr. Kaldor's suggestion for taxing the gift according to the taxable capacity of the donee (and not that of the donor) is amply justified on grounds of equity as well as certainty. If the tax is levied on the basis of donor's total

wealth or the magnitude of the gift it would be unequitable. Besides, in that case, a property owner would find it profitable to transfer his property, to his heirs, in small installments.

Coming to the question of rates, as it has been seen by revenue receipts from estate duty and from the gift tax (or both combined) the rates are too low. It is strange that the progression of tax rates which apply to estate duty and gift tax is far too small even in comparison to the progression of the income tax rates. Income is the reward of one's own efforts against the inheritance, which is a fortune coming to a person irrespective of his efforts. It can hardly be justified to take a greater part of earnings out of one's own enterprise and efforts, and a very low part of a wealth which he gets for no credit to himself.

CAPITAL GAINS TAX

Among the additional taxation measures, adopted for increasing the volume of public revenue, one was the tax on capital gains which was strongly recommended by Mr. Nicholas Kaldor. Capital gains tax was in force, in India, during the financial years 1946-48. After that it was abolished. It was reimposed by the Third Finance Act, 1956.

Capital gains are defined as "Capital Gains" in respect of any profits or gains arising from the sale, exchange, relinquishment or transfer of a capital asset effected after the 31st day of March, 1956. Capital gains are deemed to be the income of the previous year in which the gains were made.

Capital gains are taken to be a type of income, and for taxation purposes (in case of an individual) one-third of the total capital gain is added to the individual's otherwise income, and income tax is charged on the total of the two. No super tax is payable on capital gains.

This tax is payable by companies too. In case of companies, the highest rate of income tax is levied on the company's total capital gains. In case of companies too super tax is not charged on capital gains.

The argument of Mr. Kaldor in favour of Capital Gains Tax was that it is not only one's income that decides his capacity to pay taxes; one's capacity to pay is also determined by the capital gains that he makes, besides his other incomes. Therefore, in view of equity as a determinent of taxable capaci capital gains should be taken into account. But this tax has

not been approved by several authorities;[1] on the ground that this tax might cause severe disincentive on savings. The argument does not hold because capital gains are either spent on luxuries or saved (or invested). So long there is a chance for a capital gain, it would be cared by every body irrespective of the fact that a little part of the gain will be taken away as tax.

On the other hand it seems of little use, because the tax also provides for the capital losses (which are to be carried forward and set off against capital gaining during the following years). In a closed economy a gain to one party would automatically mean a loss to some other party and a great part of taxable capital gains would be off set. The rate of capital gains tax, too has been sufficiently low, and in this light, the trouble seems all the more useless.

1. For example: Taxation Enquiry Commission 1953-54, the U.K.Royal Commission on Taxation and Profits (1955), Ursula Hicks in 'Direct Taxation and Economic Growth'; Page 309.

RAILWAY PASSENGER FARE TAX

Tax on railway passenger fare was announced in the Supplementary Budget of the Government of India which was produced before the Lok Sabha on the 15th of May, 1957. Explaining the purpose of this tax the Finance Minister had said in his budget speech that "I propose to levy a tax on Railway passenger fares .... The proceeds of it, less the amount attributable to Union territories, will have to be distributed entirely to the States. The states need more resources and Railway travellers, like consumers of other commodities should, under present conditions, make a contribution."

Rates of the railway passenger fare tax were as follows:

	Rate of tax
On season tickets	Nil
For distances upto 15 miles	Nil
For distances from 16 to 30 miles	5% of fare
For distances from 31 to 500 miles	15% of fare
For distances over 500 miles	10% of fare
On milage coupons	12.5% of the cost of coupons.

According to initial estimates the yield of this tax was expected to be Rs.14 crores in full year and Rs.8 crores in the year. The tax was imposed with effect from September 15, 1957 and proceeds from the railway passenger fare tax were as given below:

	Rupees Crores
1957-58	3.68
1958-59	12.24
1959-60	12.81
1960-61 (Revised)	13.67

The tax, no doubt has proved sufficiently fruitful, though not as much as it was expected to be. In view of the administrative convenience in respect of its collection too, the proposal was remarkable. It has added a handsome amount to the resources without an additional cost of its collection.

The tax can be made more fruitful by removing the tax exemption on fares for journey below 15 miles. The exemption, it seems, was granted, either for exempting the poor class, who generally have to travel short distances or to avoid administrative inconveniences on account of calculating the fares of the low denomination tickets. None of the argument seems strong engough to justify the exemption. Firstly because the tax on railway passenger fares has nothing to do according to one's ability to pay. Rich people may have to travel a short distance and similarly poor people may have to cover long distances, and secondly that tax on small denomination tickets need not necessarily be at a certain percentage basis. In order to avoid adminis trative inconvenience in this connection certain amount of tax per passenger (or say per ticket) might be charged for travels below 15 miles.

One thing more - the tax does not make enough discrimination between the passengers of different classes. Though the ad valorem nature of this tax, places slightly greater charge on the travellers of superior classes yet, it hardly equates the burden. The tax can be made more equitable and also more profitable by slightly increasing the rate of tax of the superior classes.

GENERAL SALES TAX

At present, general sales tax is the largest single source of revenue to the States. It is sufficiently an old tax but untill independence, it was not a very paying ~~course~~ source.[1] Its importance rose with the financial requirements for the planned development of the country.

Revenue from General Sales Tax of all the states has been as follows:[2]

Year	Rupees (Crores)
1951-52	54.40
1952-53	51.21
1953-54	58.33
1954-55	66.39
1955-56	68.28
1956-57	70.66
1957-58	107.37
1958-59	111.68
1959-60	124.37
1960-61 (Revised Budget)	133.91

During the First Five Year Plan the General Sales Tax revenues experienced a slight rise i.e. about 25%, but during the Second Five Year Plan the rise was about two-fold. Over the two Plan period the rise comes out around two and a half times

1. Revenue from General Sales Tax in 1944-45 was Rs.7.91 crores only against the total revenue for all states amounting to Rs.193.87 crores: the share being about 4% only. Report of the Taxation Enquiry Commission, 1953-54: Volume I; Page 25.
2. Reserve Bank of India: Currency and Finance Reports for 1956-57 Statement 59, 58-59 Statement 59 and for 60-61 Statement 61.

against approximately a similar rise in the total revenues of the States.[1]

Though the absolute rise in the bulk of revenues from Sales Taxes is appreciable, but seems less than what it should have been, in view of the rise in the total volume of State revenues or in view of the necessity of the requirments of a very high order.

The foremost aim of the fiscal policy in a developing economy is to obtain resources for development by cutting consumption as far as possible. Union Excise Duties and the General Sales Tax of States, both tend to put a check on consumption. It has been agreed that for an effective control on consumption, excise duties and the sales tax, both are necessary. Union Excise Duties tax the consumption of certain specific articles, whereas the general sales tax is a measure to cut consumption in general. In the words of Dr. Chelliah, "whereas the general sales tax is useful device for checking increases in general consumption, particular excises are more suitable for causing inter-industry diversions of resources".[2] Thus, in view of its purpose of checking the increase of consumption in general, it appears that general sales tax has done lesser than it was expected of it. Despite about 23% rise in population during the decade and over 40% rise of industrial production during 1951-58,[3] revenues from Sales Tax did not show any remarkable rise. Sales tax, as a measure for checking general consumption, has much to do in a developing economy.

1. Total revenue of all the States was Rs.405.41 crores in 1951-52 and Rs.1010.76 crores in 1960-61.
2. R.J. Chelliah: Fiscal Policy in an Underdeveloped Economy; Page 147.
3. Reserve Bank of India: Currency and Finance Report, Page 14.

A developing economy has to adopt a redistributive policy; at least redistribution of economic power or achievement of a socialistic pattern of society has been one of the aims of our country. Redistribution of wealth increases the purchasing power of the poorer section, who normally have a great propensity to consume. Thus, demand for consumption goods or the articles of daily use increases rapidly. On the other hand, the production of consumption goods is comparatively neglected in developing economy, because of its emphasis on the production of capital goods. These state of affairs create general inflationary trend in the economy. To counteract this tendency the general sales tax, which is capable of controlling general consumption, acquires greater importance. Secondly, the general sales tax is capable of reaching those numerous people who can not be reached by the income tax. Only one to one and a half percent of our country's population is covered by the income tax. Incomes of other income earners can only be taxed by the Union excise duties and the general sales tax; and both the taxes are important in view of administrative convenience, bringing about a suitable consumption pattern, checking consumption in general etc.

There are many systems of levying sales taxes in India. The type of sales tax, most suitable for a developing under-developed country is the multi-point system. The tax should be levied at flat rate on all consumer goods, except the articles of necessity. Articles of luxury should be subjected to an additional tax. This would make the tax system a little equitable too.

As regards the rise in the proceeds from the sales tax revenue, it was for too slow during the +First Five Year Plan.

This has been one of the reasons that States miserably failed in respect of fulfilling their additional taxation target during that period. The rise from sales tax revenues during that period should have been at least 50%. During the Second Plan period, the rise in sales tax revenues may be called satisfactory. Had its rise been 50% during the First Plan period, the rate of increase from Sales Tax revenues during the Second Plan would have resulted in rich yields to the public exchequer.

LAND REVENUES

Land revenue has been an important source of States' revenues. It used to be the largest single source of revenue to the States, before sales tax took that place. In 1938-39 land revenue alone contributed 33% of the total revenue of all the states.[1] On account of the increasing importance of general sales tax, state excise duties and other taxes, the share of land revenues in the total, had declined to about 11.5%. During the First Plan period some more emphasis was laid on raising revenues from land and consequently the share of land revenue increased to 14% of the total states revenue. Afterwards, the proceeds from land revenues have showed slight increment though its share in the total has declined.

Proceeds from land revenue all over India have been as follows:[2]

Year	Rupees Crores
1951-52	47.99
1952-53	57.41
1953-54	70.73
1954-55	72.58
1955-56	80.33
1956-57	92.66
1957-58	87.33
1958-59	91.85
1959-60	95.15
1960-61 R.E.	97.98

Land revenue is still the largest single source of revenue in Uttar Pradesh, Madhya Pradesh, Bihar and Andhra. In Uttar Pradesh it holds great importance. For example in 1959-60 (Budget) a sum of Rs.2117.03 lakhs (net) was expected to be

1. Out of a total of Rs.74.86 crores, land revenues accounted for Rs.25.40 crores: Report of the Taxation Enquiry Commission; 53-54, Volume I, Page 25.
2. Reserve Bank of India: Currency and Finance Reports.

raised from land revenues.[1] This sum represented about 17.6% of the State Budget.

A great part of the increase in the receipts from land revenues has resulted from the enforcement of Zamindari abolition in several states. Many states had a Zamindari system for collecting land revenues. This system prevailed in Assam, Andhra, Bihar, Kerala, Madras, Orissa, Rajasthan, Uttar Pradesh, West Bengal etc. In most of the states the administration reached the peasant through a chain of intermediaries and collected revenue from the head, known as Zamindar. This method of tax collection was, with the administrative point of view, quite convenient and apparently involved very little cost of collection. But, a great part of the revenue thus raised, was taken up by the intermediaries as their profits and moreover they were dominating the villages with their rights and powers. There was hardly any control on their powers. Misuse of power by them was causing numerous ill effects, not only on the poor cultivator but practically on the entire social structure.

Following the enforcement of Zamindari Abolition Act, the powers and duties of the intermediaries were assumed by the State Governments. The intermediaries were granted adequate compensation. The compensation was to be given in various forms - in cash and mostly in bonds. This was thought that the compensatory obligations of the Government can be paid out of the excess revenue collections resulting after the Zamindari abolition.

Proceeds from land revenues did rise as a result of this scheme but in most of the states the increases were not sufficien for the due payment of bonds and the repudiation of loans that

1. U.P. Government budget for the year 1959-60.

were raised for payment of compensation. It is guessed that the additional proceeds from land revenue would not have any net positive effect on the financial position of the states for another one decade or more.

There would hardly be any disagreement on this new scheme of land tenure. States, of course have to experience some additional administrative inconvenience, but it is compensated by the net additions to the state revenues. On the other hand a major part of the additions or even more than that, are served on bonds and in respect of loan repayments in this connection. States may have to loose some revenue on this account, but it is bound to do much good to the cultivator and thus indirectly help in the imrpovement of crops.

Now, the ease and convenience bestowed upon the cultivator as a result of zamindari abolition, bring a case of slight increase in the rates of land revenue. The rates have not been increased in most of the states and that has been one of the reasons of slow rise in proceeds from land revenue especially during the Second Plan period.

STATE EXCISES

The Constitution has empowered State Governments to levy excise duties on alcoholic liquors and narcotics. State excises have been an important source of revenue to the States. In 1944-45, state excises formed the largest single source of State revenues.[1] Afterwards the place of state excises as source of revenue declined following the prohibition movement which started during the pre-independence period and made progress with the time. By the year 1951-52, the first year of India's planned development, the tax had considerably lost its relative importance, inspite of the fact that its absolute contribution did not drop.[2]

As one of the objectives of tax policy in an under-developed country is to curtail the consumption, the choice for taxation naturally goes to restrain the consumption of luxuries and non-necessaries. The case for a heavy taxation on liquors and narcotics drugs is strengthened by the fact that their consumption, besides being unnecessary, is also injurious for health But in view of their injurious nature, the case against the consumption of these intoxicants has gone far beyond the policy of taxing them at a high rate and a case for the complete prohibition of its consumption has appeared.

1. In 1944-45 State excises contributed Rs.43.42 crores. The second largest source was Land Revenue which contributed Rs.30.21 crores: Report of the Taxation Enquiry Commission, 1953-54: Volume I, Page 25.
2. In 1951-52 the share of state excises was Rs.49.41 crores, which stood next to the contribution by General Sales Taxes (Rs.54.40 crores) and close to Land Revenue amounting to Rs.47.99 crores: Reserve Bank of India, Currency and Finance Report for 1958-59; Statement 59.

Now, the movement for prohibition has spread all over the country. Use of opium except for medicinal purposes has been prohibited all over the country. As regards the use of liquors and Ganja etc., the prohibition is being introduced gradually. Few states have entirely prohibited the use of Ganja and liquor; some have introduced it partially.

It is true that imposition of a heavy tax on the consumption of a certain article discourages its consumption by increasing the price of the article and making it more difficult for a consumer to get it. But as Dr. Dasgupta puts it, "Economics postulates in every man the judgement necessary to distribute expenditure on the basis of equimarginal utility. Under the effects of drinking people loose this judgement. Hence, the indidence of a tax on drinking becomes arbitrary and can not be co-related to the relative paying capacity of men. For all these reasons prohibition in this country have a strong case."[1]

On the other hand the introduction of prohibition means a loss of public revenue, while revenue is a matter of foremost importance for a developing economy. Prima-facie, the loss of revenue should not be allowed in view of the huge revenue requirements for developmental expenditure. But, the loss of revenue, it can be argued, is not futile; it, as a result of prohibition, eradicates the accepted social evil and it also serves to improve the economic condition of people. Consumers of liquors and other intoxicants can save the money which they otherwise would have spent on drinking and that saving can be utilised for improving the consumption pattern of their famil

1. B. Dasgupta: Our Plans and Our Public Finance: Pages 69-70

or they can save the amount. The loss of public revenue, on the other side ~~hand~~ increases economic welfare. The purpose of raising revenue and spending it is also the same. Thus the question of prohibition or not prohibition takes a different shape. It poses a question that whether to continue raising revenue by taxing the use of intoxicants and spend it for the welfare of the people or prohibit their immoral consumption, even at the cost of revenues, and let people save the amount, spent by them on liquors and let them increase their welfare themselves.

It might be mentioned here that prohibition in itself is a social movement. It has little to do as a fiscal measure. Drinking is a non-essential consumption - and as mentioned earlier it is injurious for human beings, especially in view of the hot climate of our country. Religious, as well as public opinion is against drinking and social reformists very strongly plead the case of enforcing prohibition. The economic aspect of prohibition appears when a loss of public revenue is apprehended to result out of it. The loss has more seriously to be considered in view of the financial requirements of a very high order for the development of the country.

So far as revenues are concerned, the prohibition movement has already caused a great loss. From 1951-52 to 1960-61, where the total revenue of the States have more than doubled, revenue from State excises have not increased.[1] Revenues from the state excises have been as follows[2] -

1. In 1951-52 total revenues of all the States amounted to Rs.405.41 Crores. It went upto Rs.1010.76 Crores in 1960-61 (R.E.). The share of state excises was Rs.49.41 Crores in 1951-52 and Rs.49.59 in 1960-61. Reserve Bank of India: Currency and Finance Report, 1960-61: Statement ~~59~~ 61.
2. Reserve Bank of India Currency and Finance Reports for

Year	Rupees (Crores)	Year	Rupees (Crores)
1951-52	49.41	1956-57	42.76
1952-53	46.30	1957-58	45.73
1953-54	44.66	1958-59	46.94
1954-55	44.56	1959-60	49.60
1955-56	43.49	1960-61 (Revised)	49.59

The figures show that revenue from state excises have remained more or less steady. This steady behaviour against more than two fold increment in total state revenues and about five fold increment in the bulk of Union excises etc. is quite strange and only an unavoidable and a very important reason can justify this negligence.

Now, it is clear that the loss of about, say Rs.40 crores a year, has occured on account of the partial adoption of prohibition. The absence of prohibition would have meant a sum of about Rs.400 crores over the two Plan period. This is in no way a small loss. The question arises - why this loss? The supporters of prohibition would say that if prohibition is enforced, drunkards would save their expenditures on liquors etc. and thus they can make use of their savings for the betterment of their family interests and a part of it might also be used for contributing towards the small savings programmes in the country. But these arguments are based on a very wrong assumption that prohibition would prove completely effective. Supporters of prohibition plead that the habit of drinking makes a man loses ~~loose~~ the sense of discrimination between the articles of use according to their utility , and therefore, a heavy tax on intoxicants fails to serve its purpose of discouraging their consumption. It is strange that they do not apply this argument

in connection with the adoption of prohibition. If prohibition is enforced, people who are used to intoxicants would adopt all possible means to obtain wines, ganja, opium etc. as it is not possible for them to live without it. Thus prohibition may lead, and it can be said, has lead, to many social evils and illegal activities. It will lead to bribary, corruption and several other activities of this sort. Drunkards would not be able to save their expenditures on liquors, they will have to pay probably more for it and the stuff they would get would probably be worse. Enforcement would hardly lead to any improvement in the consumption standard of people, it would probably deteriorate it further.

Thus the basic purpose of the prohibition movement is defeated. State Governments lose ~~loose~~ revenue of a very high order practically for no good. Besides the loss in respect of state excise duties, expenditure on prohibition enforcement is added. Prohibition, thus, proves to be a double edged weapon in respect of reducing net state revenues.

Moreover, a high rate of tax on the consumption of intoxicants seems, for the present, a sufficient measure to reduce their consumption. It is possible, as it has been argued, it might not prove a sufficiently effective measure to discourage the consumption of liquors by those persons who are adicts to it, but it would definitely discourage its consumption by those who are not regular drunkards. Gradually it would itself lead to prohibition.

In view of the foregoing arguments, it seems quite unopportune to enforce prohibition, especially in view of the loss of revenues. Prohibition is a reformists' movement. It should not impair the fiscal soundness of Government especially

at present, when it is necessary to concentrate all available resources and energy to obtain one single goal - that is the economic development of the country.

OTHER SOURCES OF STATES' REVENUE

There are several other important sources of States revenues besides those which have already been mentioned (State excises, Sales tax, Land revenue) and the share that States get out of Union taxes. Among others, receipts from civil works and other administrative receipts, motor vehicle tax, stamps and registration receipts, motor spirit tax, and contribution of public enterprises are important.

The following table gives the development of receipts by the states under some important heads during the past decade:

	Agricultural Income Tax	Stamps & Registration	Sales Tax on Motor Spirit	Entertainment Tax	Electricity Duties	Motor Vehicle Tax	Other[1] Taxes & Duties	Administrative receipts and Receipts from Civil works	Net contribution of public enterprises
	2	3	4	5	6	7	8	9	10
1-52	4.33	25.56	4.53	6.39	3.39	10.09	19.69	38.13	24.92
2-53	4.06	25.99	5.97	6.14	3.42	11.76	17.34	39.13	24.18
3-54	3.77	27.70	7.35	5.88	4.76	13.67	18.65	44.14	28.44
4-55	4.77	27.05	7.27	6.22	5.24	13.67	15.96	50.95	30.11
5-56 .E.)	5.74	28.11	8.30	6.50	5.63	14.39	12.83	60.44	30.07
5-57 .E.)	5.73	29.90	8.73	6.53	5.81	14.98	14.01	66.70	34.88
7-58	7.80	33.09	9.85	8.56	7.15	21.13	20.08	82.02	42.93
3-59	8.42	35.53	12.19	10.65	10.51	24.46	20.04	104.49	39.69
9-60	8.92	40.69	12.46	11.32	11.97	26.38	23.75	122.66	43.55
0-61 .E.)	8.48	41.05	15.08	11.55	11.51	29.78	22.67	142.83	46.78

1. Sugar Cane Cess, tax on passangers and goods, tobacco duties, taxes on prize competitions and betting, inter State transit duties, tax on raw jute etc.

Administrative receipts are now contributing the largest share in state revenues. The rise in the receipts under this head has also been appreciable. The receipts under this head have increased by more than three times over the ten year period.

Stamps and registration has been another important source of State revenue. Receipts under this head were Rs. 25.56 crores in 1951-52 and have increased by about 50 percent during the ten year period.

Important changes took place in respect of sales tax on motor spirit and the motor vehicle tax. These two taxes contributed a major part in the additional taxation measures by the States during the first plan. Receipts from Sales tax on motor spirit in 1951-52 was Rs.4.53 crores and it has increased three times by 1960-61. Motor vehicle taxes raised to Rs.10.09 crores in 1951-52 and have increased by about two and a half times since then.

Net contribution of public enterprises has been slow enough and has actually amounted much below the targets. Receipts in respect of irrigation works, inspite of expanding irrigation schemes and increasing rates has been slow.

CHAPTER XV

SMALL SAVINGS

Small savings movement has on the whole proved quite successful in India.[1] Funds raised during the First Five Year Plan period, under the head of Small Savings and other unfunded debts amounted to Rs.304 crores against the target of Rs.270 crores. Receipt under this head increased during the Second Plan period, though it remained much below the target figures. It has been estimated that receipts on this account amounted around Rs.400 crores against the target of Rs.500 crores. The share of small savings in the financial resources of the Plan, also declined from 15.5% in the First Plan to about 9% in the Second Plan. Again, despite the introduction of several new methods for mobilising small savings, the average rise in the receipts during the Second Plan period over the receipts during the First Plan period has only equalled the rise of national income during the Second Plan.[2] The tendency of savings has not shown a natural bouncy with the rise in national income. Thus, small savings have not proved as encouraging a source during the Second Plan as it should have been.

Organised efforts to mobilise small savings started in 1946. This programme was set up on the lines of British Government's scheme of raising war loans during the World War period. Initially the small savings movement was run by the States, who worked as agents to the Central Government. In 1948, it was taken up by the Central Government and it was run with

1. Steps taken by Governments to increase yields from small savings have been dealt in 'Resources for the First and the Second Plan'. in the Part II.

the cooperation of the State Governments. From 1952-53, the states started receiving share out of the collection from small savings. This was a correct step and it did work in giving a push to the movement and worked as an incentive to the State Governments to extend their cooperation in making small savings programme a success.

From 1957-58, States were again made to work as agents to the Centre. This was another important step towards popularising the small savings movement. The net-work of State Governments is spread all over their respective States and thus the State Governments and their officials are more in contact with the common people. Thus the policy of giving shares out of the small savings collections to the States was quite desirable.

Savings in Rural Areas.

One serious drawback in the present system of small savings system is that it is incapable of mobilising savings in the rural areas. According to the 1961 Census about 82.16% of India's population lives in rural areas. The present opportunities for investing in small savings, such as the Post Office Savings Bank, National Plan and the National Savings Certificates etc. cannot be availed by a vast majority of people because they are far away from the knowledge of these opportunities, they are uneducated and they do not understand the utility of savings, present methods are too intricate for them and in the absence of any insistant approach they would hardly care to save.

Dr. ShantiKumar Ghosh has recommended 'Savings in kind', in order to mobilise savings in rural areas. The suggestion of Dr. Ghosh seems quite relevant but under present circumstances it seems too cumboursome to be carried out. It is apprehended

that the cost of carrying out the raising of savings in kind, would go far beyond the actual collections. Doubts regarding the success of this suggestion are confirmed in the light of far streaching villages, with widely differing nature of occupations and, the varying nature of produce.

The scheme of introducing 25 nP. savings stamps has been a remarkable arrangement in view of extending the opportunity of small savings to the low income people. But it is really doubtful that a poor man with as small a saving capacity as 25 nP. would ever go to invest it to purchase savings stamp. For this, a proper approach is needed. Government advertisements and notifications are insufficient to pursue a common man to make use of these opportunities. It needs a brisk door to door convassing. It needs an insistent pursual extending to as many people as possible.

Uneconomic Savings.

It is evident that there is only one pool of resources which is available to a community at a certain time, out of which resources are either consumed or taken away in form of taxes, loans, savings, etc. Thus all the methods of raising resources for the public sector, affect each other, and ultimately it is the reduction of present consumption that can release resources for other purposes. Besides these alternatives, in underdeveloped and backward countries, there is one more channel which claims an appreciable share of the resources. This can precisely be classed as 'uneconomic holdings'. Purchase of precious metals, ornaments, cash hoarding etc. take a good part of the community's limited resources. Similarly those little number of people who have some propensity to save, either keep

their money in their own lock-ups or invest it in uneconomic channels, such as the already mentioned ones, luxurious buildings, other articles of luxury and the like. If steps be severe to discourage uneconomic investments, people's economic saving can be increased.

Policy of the Government in respect of dealing with uneconomic savings, as already mentioned, has been too lenient. There is, yet, no excise duty on gold and other precious metals. Articles of luxuries and the 'non-necessities' are also being taxed at a very low rate. This is leading to the usual direction of the flow of available saving. A large part of our country's savings is being invested for the purchase of automobiles, luxurious textiles and other luxurious articles. There is absolutely no cut in the consumption of unnecessary articles such as betals, tobacco, spices, liquors, coffee etc., since the begining of the Plans. These facts are precisely responsible for the slow advance of small saving movement in our country.

As correctly expressed by Dr. Tripathi "the movement has not reached the small savers in the rural and urban areas and that the major portion of the collection is being derived from institutional investors and individuals with substantial savings. In order to mobilise still larger volume of resources from small savings, it is necessary not only to strength=en the existing organisation which may readh the remotest corner of a village, and the small savers in urban areas .... The small savings movement should be made the main plank of the programme to mobilise the rural savings which are generally frittered away either over conspicuous consumption or invested in land and jewellery".[1]

At present the stage has come when practically all sort of modes of small savings have been introduced by the administration. They are available in various possible denominations and have been designed to suit the pockets of all. Reasonable interests are paid on savings to attract resources and encourage people to save. Yet on the other hand, it has a dark side. Opportunities to save are such that they can be availed by only a small part of the urban population. It is beyond the knowledge, beyond the reach and beyond the mind of a good part of the urban population and practically all the people living in rural areas. The movement, precisely, lacks mass appeal; and it is a thing worth repeating that the small saving movement is essentially meant for masses; for those persons who have very little propensity to save and who are spread all over the country, forming a majority of our country's population. Now, at this stage, the movement needs popularity. In the absence of a common man's contribution towards the small savings movement, receipts under this head can hardly be distinguished from those which are raised under the head of loans from the public, as those savings come from that class of people who already have enough propensity to save, and thus their contribution does not add to the net volume of savings in the economy. What is needed at present, is to carry the message of investing in the small savings schemes to every door and to every individual. Future success of this movement will depend on its future popularity. Economic advantages of savings schemes will accrue in full only if these are accepted by the masses.

CHAPTER XVI

MARKET LOANS

Loans from the public, has been an encouraging source for financing development projects. A sum of Rs.204.4 crores was raised under this head during the First Plan period against a target of Rs.155 crores. Similarly, during the Second Plan too, the target has been crossed. Against a target of Rs.700 crores, the receipts have amounted to Rs.780 crores. The share of market loans has shown a marked increase from about 10% in the First Plan to about 17% during the Second Plan. The average of receipts under this head has risen from Rs.41 crores a year in the First Plan to Rs.~~256~~ 156 crores a year during the Second Plan. This tendency, shows the increasing inclination of people for investing in Government securities. At the same time it also indicates that the resources, having been left with the private investors, which would have, otherwise, been invested on projects of lesser importance will now be invested on projects of national importance.

In view of the necessity of some indispensable projects of common interest undertaken by the Government, and the huge expenditure required to finance them, Government has to borrow money from the public. Several investment concerns of varying nature such as individuals with enough savings, banks, insurance companies and other bodies prefer to invest in Government securities, because such an investment is deemed to be safer and steadily profitable. Contributions under the head of 'loans from the public' are made by such individuals and bodies which already possess enough capacity to save. Thus loans from the

public hardly add to the net savings of the country - it only provides for a transfer of resources from the private sector to the public sector.

It can easily be understood that projects undertaken by the Government are of greater value, they are of the national importance and of common interest, than any project undertaken by an individual or a private concern. Interest of an individual or a private body is in all probability likely to be selfish, confined to its own profit, while the Government is interested in the welfare of nation. Projects undertaken by a Government are in the interest of the nation; people as a whole; and thus a transfer from the private sector to the public sector is desirable. But, on the other hand, it does never mean that the private sector should cease to exist or it should starve for want of resources.

The two Five Year Plans have very successfully obtained resources from the private intestors to finance some of the Government projects. As already mentioned, amounts raised under these heads have outgrown their targets. Now, the increased dependence on loans from the public gives rise to three distinct queries: (i) To finance a development project, which of the two sources should be preferred - taxation or Public Debt; (ii) How far these loans have adversely affected the private investment in India? and (3) How far this source should have been relied upon?

<u>Loans versus Taxes</u>.

Problem begins with the requirement of resources for expenditure on development. For the present, the choice of obtaining resources is between loans from public and the taxes.

When taxes are raised, they mean an immediate decrease in consumption and decrease of private savings. Taxes involve a sacrifice by the people. Their sacrifice is indispensable in view of the fact that it would ultimately be they, who will reap the benefits of the undertaken projects.

On the other hand a loan from public does not involve any sacrifice from the contributor, as he contributes towards the loans of his own free will. He finds the security of his money when he invests in a Government project. Besides, he is attracted by the expectation of a positive return for such investment. Thus, with the point of view of investors, loans are definitely preferable to taxes. But, for the Government, loans mean a future liability. Loans are to be repaid and besides the repayment of actual loans, handsome amounts in the form of interest on them becomes an additional liability. With this view taxes should be preferred to the scheme of raising loans from the public.

The option has another aspect to be considered. The burden of tax, as mentioned before, goes to the people and the ultimate burden of loans, which is a liability on Government, also goes to the people. The difference between the two is that the burden of amounts raised through taxation, goes upon people living in the present; and the burden of public loans gets spread over the people living in future years. This is, because the loans raised at a certain time are paid back during the following years out of the revenues raised in those years, and thus loans at a certain time become a tax liability on people during the years to come.

In spite of the fact that the burden of both the

sources, is ultimately to be borne by people, the case for raising loans from public, does not loose its importance. The choice between taxation and public debt takes the shape of choosing between sacrifice by people at present or the sacrifice distributed over a period of time. The first of the two, is generally an impossibility in an underdeveloped country. Raising all the required amount by taxation in a country, might in all probability, run the economy into doom. Choice naturally goes to the second alternative. Justification for spreading the tax burden over the following years is that not only the present population but the future population will also reap the benefits of the projects in question and thus they must share the burden of financing the development schemes. Public loan, thus, serves as a wonderful method of taxingthe people, living in the following years.

Thus, the question does not arise of choosing between taxation and raising loans from the public; both have to exist. On these grounds, our scheme of financing followed a correct pattern and Public Debt has played its part.

Public Sector Versus Private Sector.

It has already been mentioned that increase in public debt does not add to the savings in the country; it only transfers resources from the private sector to the Public Sector. In a mixed economy, over-emphasis on public debt by the Government might starve the private sector and paralyse economic activity of that sector.

Over contribution under the head of loans from the public, during both the Plans does not necessarily mean that the public sector in India has encroached upon the resources of

the private sector. Targets for raising resources under this head were not placed in the light of any specific calculation, beyond which public debt will affect the private sector adversely. Targets were fixed in the light of possibilities - the possible sum that could be raised as loans from the public. Favourable respond on this account during 1951-56, lead for an expectation of receipts of a higher order during the Second Plan period; and that too has been over subscribed.

The transfer of resources from the private sector to the public sector can affect production in two ways. Firstly, it may discourage investment on some projects of common interest and of national importance which would have otherwise been undertaken by the private sector; or secondly by taking away, from the private sector, that part of investment potential that would have been utilised for comparatively unimportant purposes. Like most of the underdeveloped countries, in India too, there has been little likelihood that (barring a few) any major project of national importanme or far - stretching common interest could be taken up by private investors. Thus, prima-facie, it might be taken for granted that, Public Debt has not enchroached upon any important field of private investment.

Besides, during both the Plans, Government has taken sufficient steps to ensure an unhampered working of the private sector, especially in fields of activity which are of vital importance to the country. Several credit facilities to the private investor were extended all over India. Foreign loans and equipment was made available to them by various agreements and necessary handling of foreign exchange difficulties. With the result, that investment by the private sector during the

First Plan aggregated around Rs.1800 crores and during the Second Plan, to Rs.3100 crores.[1] Investment targets by the public sector were overfulfilled in both the periods.

On these results it can be concluded that public debt during these two Five Year Plan periods has not at all adversely affected the private sector.

Share of public debt

It has already been mentioned that public debt imposes a liability on the Government but still it cannot and should not be avoided. Necessity of public debt can be reduced by obtaining rescurces by raising taxation but that too has a limit. Therefore, determination of the limit of public debt raises a relevant question. In short, at the most only that part of a particular project should be financed by raising loans from the public, the repayment liability for which can easily be paid back out of the project's net profit on that share. Remaining expenditure should, as far as possible be financed by way of taxation.

As already mentioned, the tax policy of the Government has been slightly below the reasonable level. But that part should have gone to cover the deficits and the public debt, it can be said, has played its part correctly.

1. Reserve Bank of India: Currency and Finance Report for 1960-61; Page 2.

CHAPTER XVII

DEFICIT FINANCING

Large scale deficit financing has been an important feature of the first two Plans. It has also been mentioned in the foregoing pages that deficit financing is sometimes necessary to give a push to a developing economy. The major defect in the scheme of using created money for financing the plans was that its use has been unplanned. Deficits were financed as and when they occured. The magnitude of deficit financing in any particular year was neither preplanned nor significantly purposive. Wide and unharmonic fluctuations in the magnitudes of deficits over the past decade, as given below,[1] can immediately be marked:

Rupees Crores

Year	Deficit financing Centre and the States.
1951-52	+ (Surplus) 10.3
1952-53	80.7
1953-54	72.4
1954-55	91.3
1955-56	210.97[2]
1956-57	253
1957-58	496
1958-59	136
1959-60 / 1960-61	63

Deficits during the First Plan show wide fluctuations from Rs.10.3 crore surplus to a deficit exceeding Rs.200 crore

1. The Review of the First Five Year Plan and Report on Currency and Finance, 1959-60; Page 63 and for 1960-61 Page 79.

in a year. Especially the concentration of deficit financing during the last year of the First Plan was of a very high order. It was lately realised that it was, to a great extent, responsible for causing the inflationary pressure at the time of the begining of Second Plan and subsequently raised its cost. Similarly its unplanned application during the Second Five Year Plan period has generated inflation in the economy. The index number of money supply in 1960 stood at 161 with its base 100 in 1953. The index number of money supply rose to 123 in 1956 and then continued to rise rapidly during the following years.[1] Subsequently the index number of wholesale prices has risen very sharply. With its base in 1953 equal to 100, it was 99 in 1956 and since then prices continued to rise rapidly till it touched 120 in December 1960.[2]

Actual deficits over the First Plan period crossed the prethought maximum limit of Rs.290 crores, by over Rs.130 crores. This was definitely undesirable, in view of the fact that all the excess deficit financing accounted for the last year. The Second Plan deficits have amounted a little below the safe limit fixed in this respect, but its magnitude has fluctuated widely over the Plan period.

Deficit financing in a developing economy is like fire which can be of immense use to humanity provided it is not handled carelessly. As a matter of fact, every single step taken in a plan should be very well planned in itself. Despite the overall limit of deficit financing over five years, its magnitude during every single year should be carefully determined in view

1. Currency and Finance Report for 1960-61; Statement 1.
2. Ibid.

of other factors which influence the economy. Deficit financing should not only be used as a passive instrument to cover the inevitable gap between the available resources and the expenditure target of a particular year. It should be used as a positive source of development finance.

This fact was completely ignored. The practice was that yearly Plans were formulated every year and expenditure required on it was estimated. The estimates of available resources in the light of new proposals followed. The gap between the expenditure and resources was covered by injecting additional money into the system. Thus as it happened, deficit financing was always used as a passive resource, while it should have been used as a positive measure for financing the planned economic development.

The choice between deficit financing, foreign assistance and internal taxation has been a matter of dispute. Dr. R.N. Tripathi is of the view that "created money as a device of development financing is a much better alternative than foreign loans." He further says that "Apart from the fact that foreign loans impose a burden on the economy, they are dangerous for the political freedom and economic independence of a developing country. If created money results into inflation, it imposes a curtailment of consumption in real terms." He disfavours foreign loans on the grounds that "the payment of foreign loans necessitates that the country must export more to earn necessary foreign exchange. But a rise in export can be brought about only if restraint is placed upon domestic consumption."[1]

1. R.N. Tripathi: Federal Finance in a Developing Economy; Page 154.

Dr. Tripathi's arguments do not apply especially in case of India's past development period. The problem of India's exports was not as much that of the shortage of goods available for exports - on the contrary it was on account of the absence of enough foreign markets that exports could not rise. The pattern and quality of India's export goods has been of a primitive nature too. Under these conditions a check of consumption by deficit financing could not have increased the value of country's exports. And thus, deficit financing was altogether incapable of replacing a foreign loan. A deficit on account of foreign trade balance could never be covered by internal deficit financing.

Next comes the option of choosing between deficit financing and indirext taxation. Both these measures apparently are same, as they both result in raising the prices of goods and commodities and decrease the purchasing power of consumers. Thus they both tend to keep a check on consumption. But a careful analysis points out the difference between the two. Deficit financing results into a general price rise. All commodities - necessities and others -- are equally affected by it as deficit financing raises consumer's purchasing power in monetary terms only. While taxation, especially commodity taxation reduces the consumer's purchasing power only in respect of those commodities which are subjected to the tax. Such commodities in general are, and should be, non-necessities. In short deficit financing is liable to distort the consumption pattern also while commodity taxation spares the necessities. It puts a check on the consumption of the non-necessary articles. In the light

of this significant fact the choice goes to commodity taxation. But, obviously it is not between choosing one and dropping the other; a reasonable balance between the two is to be sought.

Deficit financing should be applied in coordination with the taxation measures. Taxation, especially commodity taxation, should be used together with deficit financing to guard against the distortion of consumption pattern and secondly to check the accumulation of inflationary pressure.

Deficit financing during the past years of planned development has not shown any such coordination. As mentioned earlier also, it has been used in an unplanned manner, only as a passive instrument to cover the gap between the actually available resources and the pre-fixed expenditure targets.

CHAPTER XVIII

EXTERNAL ASSISTANCE

The statement does not need repetition that foreign aids and loans are indispensable in order to finance the increasing balance of payments' deficit on account of increasing capital import requirements of a developing economy. ~~Eternal~~ External assistance financed as much as Rs.188 Crores[1] of the First Five Year Plan and it has been estimated that the share of external assistance in the financing of the Second Plan has been of the order of Rs.1,090 Crores.[2] Assistance actually availed during the Second Plan has out-grown the initially expected level. Thus, external resources have played an important part in the financi of the two Plans, especially the Second Plan.

Foreign assistance, besides being indispensable and beneficial, like any other debt, adds to liability on the natio The burden of repayment goes on increasing with the total magni tude of the assistance received. The burden of repayment of capital and interest on foreign loans now amounting to less tha 2% of the export earnings, is expected by the Planning Commissi to rise during the sixties to nearly a fourth of the present export proceeds. Repayment liabilities of such a high order, and increasing import requirements in near future are liable t aggravate the balance of payments position further. These ant cipations seem all the more disappointing in the light of coun decreasing exports.

1. The Review.
2. Reserve Bank of India: Currency and Finance Report, 1960-61; Page 79.

It has been a matter of grave concern that against rapidly rising imports to our country, exports have recently shown a marked decline inspite of Government's best efforts to boost up the exports. The following table gives India's exports imports and the balance position during the past decade.

Rupees Crores[1]

Year	Imports	Exports	Trade Balance
1950-51	650.3	646.8	- 3.5
1951-52	962.9	730.3	-232.8
1952-53	633.0	601.9	- 31.1
1953-54	591.8	539.7	- 52.1
1954-55 Preliminary	750.6	641.1	-109.5
1955-56	761.4	640.2	-121.2
1956-57	1099.5	635.2	-464.3
1957-58	1233.6	668.5	-565.1
1958-59	1029.0	576.3	-452.7
1959-60 Revised	924.5	623.2	-301.3
1960-61	1088.0	631.9	-456.1

A deficit in the balance of trade has occured in all the years. Some how the imports and exports have risen and gone down simultaneously. The year 1953-54 in which imports were of sufficiently low order, the level of exports also drop down to a considerably low level. Decline in the level of exp has again started after 1957-58. This tendency has been disap ting. Exports should, on the other hand, have increased.

1. Reserve Bank of India: Currency and Finance Reports for 1956-57, Statement 71; for 1958-59, Statement 72; and for 1960-61, Statement 76.

One of the main reasons of India's decreasing exports have been that the country continued exporting same goods to the same countries. It lagged behind in exploring new markets for its goods. Rising prices and increasing internal consumption raised the cost of production of Indian export goods and made them less attractive for the importing countries. The pattern of Indian export items is still primitive in nature. India has been exporting, and still exports, agricultural produce such as tea, tobacco, jute, spices, etc. while demand of the countries has changed over to the imports of petroleum, mineral products and the like. Jute manufactures still form about 25% of the country's total exports. Tea and cotton textiles make another about 20% and 10% respectively. Almost another 25% of the total is formed by vegetable oils, nuts, fruits and vegetables, gums, resins, hides and skins and leather. There has practically been no improvement in the pattern, quality and the prices of the export goods.

Present state of affairs are such that thoughts relating to the solution of this problem lead to favour the assistance of foreign loans. The deficit on account of the trade balance cannot, in near future, be reduced by stepping up export nor the import of capital be reduced. Things can be improved only if the country starts producing finished goods of improved quality and of lower prices; and can manufacture a part of its future capital requirements -- machines and tools etc. -- internally. But again, for these things, foreign assistance -- technical and capital -- is required. This cannot be avoided, and probably the magnitude of assistance utilised during the Second Plan could not have been avoided.

Under such a tense situation, all over the past decad wheat loans and assistances under P.L. 480 and P.L. 665, seem inopportune. Wheat loan from U.S.A., authorised and utilised during the First Plan, amounted to Rs.90.3 crores. Assistance under P.L. 480 and P.L. 665 during the First Plan was of Rs.16.0 crores and all of it was utilised. Under this very head, assistance worth Rs.329 crores was authorised and out of that as much as Rs.254 crores was utilised within the first three years of the Second Plan.[1] Though domestic food shortage has to a great extent been responsible for the utilisation of these loans and assistances but, nevertheless, such imports should have been dealt with greater restraint.

Figures given below show the imports of grains, pulses and flour etc. during the past few years.[2]

IMPORTS

Year	Quantity (in thousand tons)	Value (Rupees Crores)
1951-52	4793	228.12
1952-53	3999	161.28
1953-54	1436	72.48
1954-55	1227	68.37
1955-56	432	29.00
1956-57	2126	102.00
1957-58	3692	150.00

The level of food imports during the Second Plan has been much above the average expected level. This has been a serious trouble, especially in view of the financial hard-pressedness during past planned development period. These state of affairs have been pointing towards the desirability

1. Currecny and Finance Report for 1958-59; Page 78.

of greater efforts on the food front.

It can be concluded that the magnitude of external assistance, but for the increased imports of the consumption goods, has been desirable and indispensable. Though it can also not be denied that it was of a very high order especially during the Second Five Year Plan and that it has already placed enough liability on the nation. But development cannot gain the desired momentum without foreign assistance. In the Third Plan, as much as Rs.2,200 crores are expected to be raised externally. The Fourth Plan might have to depend on it even more, and as estimated by the Planning Commission, repayment liability may go up to cover one fourth of our export capacity by the late sixties.

External assistance of such a high order, and the increasing repayment liabilities have not gone beyond the reasonable limit, it can be said, especially in view of the Finance Minister' recent statement that India would not require external assistance after 10 years (about 1970). If by 1970, country is able to produce the necessary capital equipment internally and change over to an advanced pattern of production, the foreign assistance has been worth taking. During the time, the country should make its best to increase its export earnings by producing new, better and cheaper goods.

PART IV

(Conclusions and Suggestions)

CHAPTER XIX

DEVELOPMENT FINANCE

Financial requirements of a developing economy are enormous. The burden of financing the development has, mainly to be shouldered by the Government. Thus, public finance becomes the basic tool for mobilising the resources for financing the development programmes. Developing economy places an increased responsibility on the system of public finance. It has an unusual task to handle and a new role to perform. Public finance, in a poor economy planning for development, changes its character so much as to become Development Finance.

The usual, though not rigidly, the practice in public finance is that the volume of public revenue is determined by the required public expenditure during a certain financial year. Under normal circumstances, the routine responsibilities of a state, involve an expenditure and revenue of comparatively a low order. Then, total volume of public revenue is not the major consideration. Functions to be performed by the State and the expenditure required to finance them, are mainly the guiding factors which determine the size of public revenue. Though the size of public revenue is conditioned by the general economic conditions of the country, yet the routine financial requirements of the State are within its capacity to raise. On the other hand, the requirements to finance the development of a poor economy are so large that even a sum equal to four-five times of the country's national income might fall short. It is impossible to raise revenue to the extent required to finance the development of a poor country.

Thus the main thesis in development finance is that the expenditure should be determined by the resources which can be made available for financing the development. The basic approach in this connection should, thus, be over against the convention practiced in public finance, where public revenue is determined by the public expenditure. "Cut your coat according to the length of the cloth," should be taken as a principle in development finance.

In practice, this principle has to be followed in respect of taking a great many fundamental decisions related to the development programmes. The whole programme as it has also been done in India, is divided into convenient parts and is spread over convenient periods of time in the light of the necessity of development projects and the country's capacity to undertake them. But, the estimates of available resources follow the estimates expenditure required on the programmes. This unopportune method is invariably liable to create a disbalance between the requisite expenditure on undertaken projects and the reasonable extent to which the resources can possibly be raised.

It must be recogn ised that fulfilment of a certain programme only is not sufficient to ensure the economic development of a country. The existing low ratio of savings and taxation to the national income of a poor country is to be raised to a higher level. Raising of these levels in an economy should neither be too slow, so as to be incapable of giving economy the minimum push; nor so fast as to destruct its development potential. The rate of rise in the level of taxation and savings in the economy has thus to be 'optimum'. This optimum should decide the level of expenditure on development programme.

Financing capacity of a state is conditioned by the productivity of its budgetary resources. Beyond that it has to resort to assistance received from foreign countries; and deficit financing. As mentioned above, internal resources should only be increased at an optimum rate. At a certain time, it is not advisable to go beyond that limit. Thus, internal resources are bound by their limitations. External resources - on the other hand - are uncertain; and deficit financing has its own limits if its evil effects on the economy are to be avoided. Limited capacity of all these resources serves to endorse the limited character of total resources, available for investment, on development of a poor country.

If undertaken development programmes require an expenditure beyond the country's current capacity to finance, the process is liable to adversely affect the economy in following ways:

It may impose unduly high tax-burdens on the people if taxation is used to finance the gap between the required expenditure and available resources. Though it cannot be denied that taxes in underdeveloped countries generally form a very low percentage of their national income (as compared to the developed countries) still it hardly needs an explanation that a sudden rise in the rate of taxation is bound to affect the country's future potentialities adversely. At the same time it is amenable to give rise to numerous immoral activities - such as tax avoidance, bribery, injustice and the like - in the country.

If over reliance is laid on market loans and other obligatory capital receipts, the burden of repayment of the loans and their interest is then bound to hamper the smooth development of economy during the following years. It might as well result in

slowing down the economic activity in public sector.

If it is decided to fill the gap by increased external assistance, no matter how it comes, and loans are raised from foreign countries without discrimination, then in the light of their economic and political after-effects the decision is in all probability liable to run the country into economic slavery of the creditor countries. It has already been emphasised in the foregoing pages that external assistance and loans should absolutely be free of political implications and that the burden of their repayment should be easily within reach of the country's capacity to repay. Raising excessive foreign loans is thus bound to violate even the fundamental pre-requisites for an unhampered development of a pooreconomy.

In practice, as it has also happened in respect of India's First and the Second Five Year Plans, internal as well as external efforts for raising necessary resources, cease to be fruitful much before their optimum level is reached. The remaining burden is covered by deficit financing. The gap is financed by the created money, whenever required, in whatever quantity. Evils of deficit financing, expecially in an underdeveloped economy are numerous. It might be recalled here that the opinion of various specialised agencies[1] was "unanimous in working against dangers of inflationary methods in connection with economic development"[2] of underdeveloped countries.

Again, if none of the above mentioned methods is adopted, the plan remains unfulfilled. Targets remain unachieved. This shortfall has its own undesirable offset. This serves to severe

1. Food and Agricultural Organisation of U.N; I.B.R.D., I.M.F; I.L.O; and several others.
2. U.N. Department of Economic Affairs: Methods of Financing Economic Development in Underdeveloped Countries; Page 10.

people's confidence in the Government and their faith in the Plan. Such a thing, as it has actually happened in both the five year plans in India, is extremely undesirable. Economic development of an underdeveloped country cannot be achieved in the absence of positive cooperation and whole hearted support of its people.

Hypothetically there might be another possibility where the available resources outgrow the expenditure required to finance the undertaken programmes. In such a case the excess part of available resources would remain unexploited and, therefore, rate of development will remain slow.

Foregoing arguments give reasons in support of the proposition that development programmes should be planned in such a fashion that expenditure on them does not exceed the available resources[1] during a certain period. To put it more precisely - the level of available resources should be the independent variable and it should be determined in the light of optimum measures of taxation, small savings, loans, foreign assistance, deficit financing etc. These are ultimately the tools with which a Government can foster the economic development of a country. These are the factors which govern the economic activity. Plan ning of economic development should mean a planned method of controlling these factors. If these factors are used as independent variables and gradually taken towards their optimum level at a reasonable rate - development planning would give most successful results.

Besides this principle would ensure a gradual strengthening of country's internal resources. Wastage of national energy

1. The term available resources includes, besides the internal budgetary resources and external assistance , reasonable amount of deficit financing also (discussion about which will follow).

on account of the uncertainty of resources would be saved. Political implications of the external resources can easily be avoided. Above all, best can be made out of the so called worst measure - deficit financing. Thus, with the certainty of required resources, plans can go with greater confidence and public co-operation.

CHAPTER XX

ADDITIONAL TAXATION

As the rate of savings is extremely low in underdeveloped countries, increased taxation becomes indispensable to finance the economic development programmes. Besides its other functions, it has to be employed as a compulsory measure for mobilising savings in the country.

The foremost question in this context is that to what extent additional taxation should be exercised? The distribution of total burden of additional tax, on different class of people is a matter of secondary consideration.

The Magnitude

The magnitude of additional taxation should be arrived at by taking into consideration the prevailing level of taxation in the country. Low ratio of tax revenues to the national income is a common feature among most of the underdeveloped countries. On the other hand this ratio is as high as 20 to 30% in the developed countries. With the economic development of poor countries, this ratio has to increase. But this change can not be affected all at once. It has to be brought about gradually. The desired rate, say 20%, may be reached after a convenient period of time. In case of India, it is to be reached in about 25 years of planned development i.e. by the end of the Fifth Five Year Plan. Before the begining of First Five Year Plan only about 6% of India's national income was being raised as tax revenues. Thus, the rate was to be raised from 6% to 20% by the end of the Fifth Five Year Plan. Targets, in between these two percentages, could be fixed upto which the rate of tax revenue was to be taken by the end of First, Second, Third and Fourth Five Year Plans - and finally the

rate was to become 20% by the end of the Fifth Plan period.¯ The rate should also rise gradually over the five year period. The volume of additional tax revenue can most suitably be determined in the light of the target tax-national income ratio, desired to be reached within the period of time in question.

Actual yield from the additional taxes imposed during the First Plan period amounted far below the target level. Contrary to it, the actual revenue raised from the additional tax measures adopted during the Second Plan substantiated as high as over two times of the target on that account. These facts serve to show that the estimates in respect of the potentialities of additional tax measures, were neither made with a view to raise the tax-national income ratio of India to a prefixed reasonable level nor their implementation was carried out on a planned basis. It is clear that no importance was attached in taking the level of taxation to a certain level. Taxation, like all other financial resources, was handled in a haphazard manner to raise as much amount as possible. The usual, normal time, practice of public finance was adopted where the expenditure is looked as an independent variable and the financial resources vary in accordance with the requirments. This unplanned manner of resource handling is always liable to mitigate their fruitfulness.

<u>The New Taxes</u>

An examination of additional tax imposition during the last ten years of India's planned economic development shows that efforts to realise the additional taxation were neither regular nor gradual. In the second year of the First Five Year Plan, no additional tax was proposed; while in the first year tax measures were introduced to raise as much as 32 crores. Similarly in the second year of the Second Five Year Plan taxes were added to

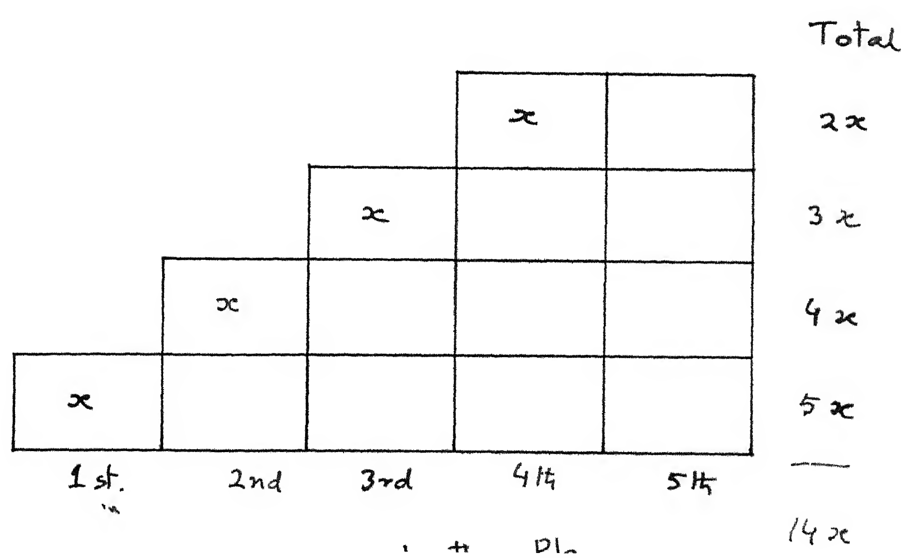
yield as high as Rs.90 crores in one year against very low additional taxes in other years. The range varied widely. With a view to fulfil targets and also of economic stability a planned approach is necessary.

A Suggestion

In order to ensure a gradual increase of tax level over the plan period and the fulfilment of additional tax target it is absolutely necessary that the tax efforts be calculated and pre-planned. If target of the additional tax revenue is reasonable, (which should always be) all possible measures should be taken to fulfil them and efforts should begin from the very first year of the period.

In the first year of a Five Year Plan, additional taxes should be imposed to raise an amount equal to 1/14 of the five year additional taxation target and additional tax measures, to yield similar amounts, should be adopted also during the following years. This method would ensure the fulfilment of five year target, in four years. The fifth year might be left for additional tax relief or for meeting unforeseen emergencies.

RISE OF ADDITIONAL TAXATION

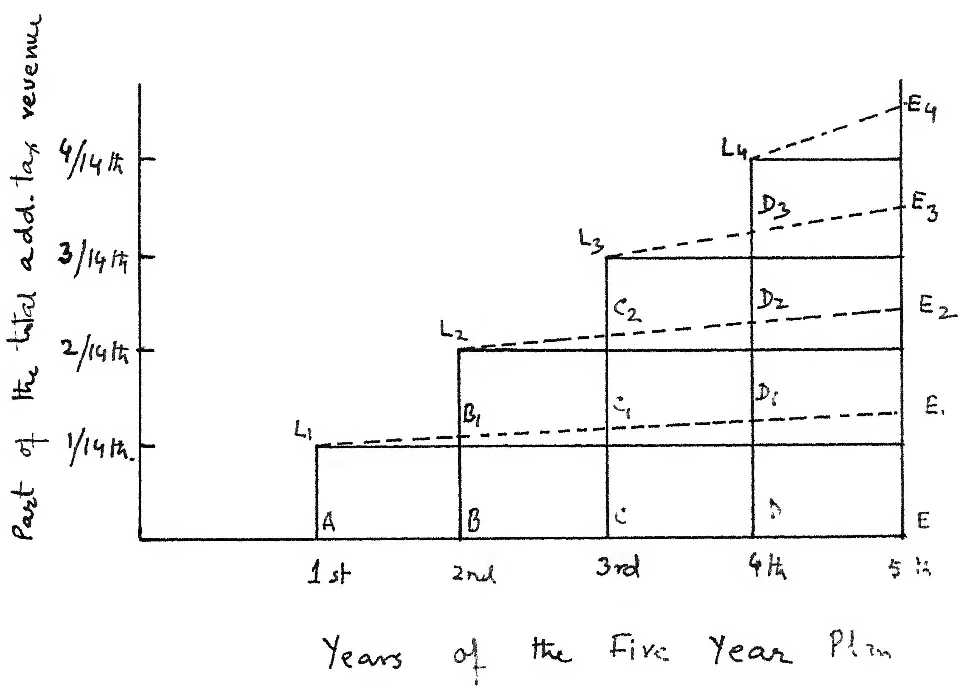


The proposition can easily be explained. Suppose the additional taxation adopted during the first year of a Five Year Plan is to yield Rs. X crores. It can be understood that those very additional taxation measures would contribute Rs.5 X crores towards the revenue over the five year period. Similarly new taxes employed during the second year of the Five Year Plan would, by the end of the Plan period, yield another Rs.4 X crores. Again, the contribution of equivalent additional taxation measures adopted in the third and the fourth year of the Plan would be Rs.3 X crores and Rs.2 X crores respectively. Thus the total yeild of additional taxation during the first four years of the Five Year Plan will aggregate to Rs.5 X crores plus Rs.4 X crores plus Rs.3 X crores plus Rs.2 X crores i.e. Rs.14 X crores. This approves the idea that if annual additional taxes be imposed to yield a sum equal to one fourteenth of the five year additional taxation target, it would be fulfilled; besides no increased taxation would be required in the fifth year. If necessary and possible, new and unforeseen additional measures can be adopted in the last year to recoup past deficiencies, if any, or to meet contingencies.

The suggestion is based on the presumption that the yield of tax measures introduced during a certain year would not automatically go on increasing during the subsequent years. This has been a matter of observation regarding the tax yields in India. Indian tax system has not shown the natural tendency of automatic increase (bouncy) in the tax yields with the increase in national income, while this is common feature of the tax system of most of the developed countries. The observation of Mr. Nicholas Kaldor are in agreement with this statement.[1]

1. Indian Tax Reform: Nicholas Kaldor: Page 1.

If the case is different and yields automatically increase with the rise of national income in following years, additional efforts would become all the more simple. After introducing the new taxes to raise revenue equal to one-fourteenth of the five-year target, necessity of additional taxation in subsequent years would go on decreasing. The proposition can be presented graphically.



In the graph, AL_1 represents the yield of additional taxation introduced during the first year of the Five Year Plan, that is equal to one-fourteenth of the total revenue desired to be raised by additional taxation over the five year period. BL_2, CL_3, DL_4 etc. which equal 2/14th, 3/14th and 4/14th part respectively of the total target additional taxation revenue, represent

the desired total yield of additional taxes at the end of the second, third and fourth years of the Plan. If the revenue from the additional taxes increases in the following years with the increase in national income, the yield in the second year ~~out~~ from the taxes introuuced in the first year, would amount to something more than AL_1. This is shown in the graph by BB_1. Thus fresh taxes in the second year of the Plan would only be required to raise an amount equal to $B_1 L_2$ - which would be less than one fourteenth part of five year target. Similarly the requirement of additional taxation during later years will go on decreasing and the possibilities are that the additional taxation target will be achieved much earlier.

The main purpose of such a suggestion is to ensure the fulfilment of target and a gradually progressing distribution of the tax burden over the five year period. Such an arrangement ensures a planned increment of the tax level itself; and it can not be denied that not only the plan as a whole, but also its very single component should be properly planned. Besides, taxation is one of the most powerful fiscal instrument with the Government for the control of economy. It has a very important role for combating inflation in a developing economy, especially where deficit financing is being exercised to supplement the resources. If tax measures and the financed deficits are not pre-planned in themselves, and also in relation to each other, adverse effects are inescapable.

The proposed scheme of deficit financing, given on the following pages, will clearly show another distinct advantage of these proposals.

Centre and the States

The results of the First and the Second Five Year Plans

have clearly shown that the Centre has greater capacity to raise additional taxes than the states. Indian tax system itself is such that fairly large number of taxes lie in the hands of the Centre. Besides, the present emphasis is on promoting a socialistic pattern of society in the country and the checking of consumption. Thus equality taxes and the commodity taxes have been predominating the Indian tax structure. In view of the fact that most of the equality taxes, and the more important commodity tax i.e. Union excise duties, are levied by the Centre, the Centre's capacity to raise additional taxes is naturally far more than that of the States.

In the First Plan, additional tax responsibility mainly rested with the States and great disappointment on that part was soon realised. In the Second Plan it was thought that the Centre and States would equally share the additional tax responsibility. But the latest estimates on that account reveal that yields through the additional tax measures of the Centre totalled about three times than that of the States.

Consequently in view of the nature of tax powers with the Centre and the States; present emphasis on equality and checking of consumption; and finally on the basis of previous results, it can be suggested that additional tax responsibility should be shared between the Centre and the States in the ratio of 2:1.

Considerations in Taxation

Equality, administrative efficiency and revenue yields are the three most commonly accepted considerations in connection with taxation. It is true that taxation is not only guided by the financial objectives, it has several social implications too.

An underdeveloped country generally has a very small group of very rich people and on the other hand very poor population of a very high order. The last war has to a very great extent widened this disparity. Such a set of conditions, in which few continue to retain vast economic power over many, can hardly be regarded as any thing but the neglect of social justice. Thus the policy of redistribution of income and wealth becomes a major consideration in taxation. With this view, increasing rate of tax on income, estate duties, wealth tax, gift tax etc. have been imposed. But the practice of granting too many exemptions, abatements and exceptions, in all the taxes, on grounds of equality only serve to complicate the tax structure and provide loopholes for tax evasions.

It can easily be observed that the Indian tax system has over emphasised the consideration of equity even at the cost of administrative efficiency and great revenue losses.[1] Besides, the estimates of tax evasions are also enormous. The findings of the Taxation Enquiry Commission 1953-54 are in agreement that tax evasion was prevalent in India on a considerable scale. Observations regarding the detected cases of evasions reveal that the difference between the income as originally returned and that disclosed later was, on the average, as high as 600 percent.[2] These are obviously the results of almost confiscatory rate of taxation on higher income slabs and the variety of exceptions, exemptions and abatements granted in practically all the taxes.

1. According to the Plan estimates a sum of Rs.350 crores was expected to be saved out of current revenues, at 1955-56 rates of taxation, during the Second Plan period; but against the expectation savings turned up into a loss of about Rs.500 Crores.
2. Report of the Taxation Enquiry Commission, Volume II, Page 189.

It should clearly be recognised that the incidence of high taxation on assessees belonging to the higher income group is quite liable to be shifted to the poor people group. This is more likely in a country like India where the economy is largely in the hands of private manufacturers. Secondly, it should be recognised that India is something more than a country. It is rightly called a sub-continent. It is inhabited by people who have different ways of living. There manners and customs differ widely. They are divided into several religious groups and the like. If a tax system goes to grant exemptions, exceptions and abatements to all people (as it is being done in India) and if the tax system cares to take account of all these groups and sects - there would be no end to it. The period of economic development should be treated as a period of national crisis. It should be remembered that "one who pleases every body pleases no body". Tax system during this period of national crisis and emergency should not be adjusted with a view to satisfy the religious and social sects and their traditions. Taxation should be governed by its national importance and all other individual and sectorial requirements should be left to be adjusted in the light of national requirements.

When such a policy is neglected, or it is not followed strictly, the result of such exemptions and exceptions, is the loss of administrative energy and the loss of resources for development. Planned development of a country clearly means that all individual, sectorial and group plans should be framed in accordance with the national plan, to achieve the national objectives - and not that the national plan should suffer for individual and sectional interests.

CHAPTER XXI

DEFICIT FINANCING

Deficit financing, in relation to the economic development of an underdeveloped country, has probably been the most disputed topic. It is commonly held that deficit financing distorts the pattern of production of underdeveloped countries; and that is the foremost reason that the specialised agencies[1] all over the world have unanimously warned against the inflationary methods of financing the development.[2] Yet, it has been discussed and made sufficiently clear in the Part I of the present work that it is always necessary, in order to finance the economic development of an underdeveloped country, to supplement the available resources by deficit financing. Conclusion is inescapable that there is an optimum limit within which deficit financing can be used safely.

It can easily be understood that all deficit financing is not inflationary. There are certain forces, that come to act in a developing economy, and make the increase in money supply desirable. Increasing imports in the poor country, on account of the indispensable foreign loans and assistances; increased production as a result of all-round expanding economic activities; expansion of monetised sector and the increasing use of money; and finally the growing emphasis and organised efforts to mobilise small savings especially from the low income people - all are deflationary in character and necessitate deficit financing in view of the economic stability. Excessive deficit financing does lead to inflation. It gives rise to the commodity prices. It is

1. U.N.: Methods of Financing Economic Development in Under-developed Countries; Foreward.
2. Ibid; Page 10.

still more dangerous when inflation is allowed to continue. Continued inflationary deficit financing is liable to lead economy into the grip of hyper-inflation where, even the factor costs are increased. Thus it can be concluded that it is inflationary deficit financing that is undesirable; and that inflation should never be allowed to persist in the economy and develop into hyper-inflation.

As a matter of fact a slight inflation serves as an incentive to produce more. It would not be inopportune to mention here an interesting reply given by Mr. Ford, when he was asked to give the secret of becoming rich. He said that he allowed his wife to spend as much as she could; and he went on thinking and working to fulfil her financial requirements. The statement is just an off-hand remark, yet, it does provide a basis to conclude that necessities induce an additional energy to work.

If an individual spends more than his resources (including savings, borrowings etc.) he can possibly finance the excess expenditure by issuing cheques. Such a way of financing expenditure in private finance, is similar to deficit financing in a public budget. The analogy can be drawn further. Deficit financing in private finance should be of such a magnitude upto which the individual can raise his resources; otherwise his purchasing power would be reduced (as the payment on cheques, which are not of the nature of a loan and their disposal can not be delayed, will in that case have to be made out of his existing resources and thereby reducing his initial purchasing power.) Thus deficit financing would be a very successful source of development financing, if enough emphasis is laid on projects capable of increasing the country's production in short time.

The policy of redistribution of wealth, that is

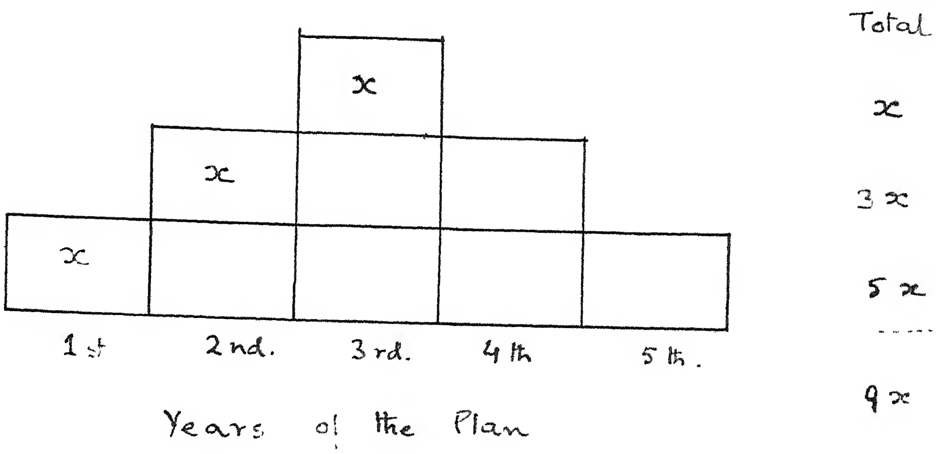
transferring resources from the rich to the poor, itself is inflationary. The wealth that lies inert with the rich, on being transferred to poor exercises a pressure on demand especially of necessities. Besides, increasing employment, investment, exports and credits given by the private banks are all inflationary. The policy of redistribution received sufficient emphasis in India. Increase in investment and employment etc. were also necessary. This all kept the scope for deficit financing, sufficiently limited. In the light of these discussions, the First Plan can be charged for having excessive reliance on deficit financing and the Second Plan for comparative negligence of agriculture etc. (production of necessaries).

The second defect regarding the use of deficit financing was, that deficits were neither systematic nor purposive. In other words, as it has already been mentioned, deficit financing in India was used as a passive instrument to fill the gaps in expenditure and the available resources, as and when they occured. It is known that deficit financing brings inflationary tendencies with it. It is also acceptable that slight inflation provides incentive for increased production. But, to make the best of it, inflation should neither be unplanned nor persistant. Fasts do improve the digestive system but a fast should be planned and not accidental. Nor a fast should continue too long. Similarly in case of private finance, an individual's deficits should be pre-planned; reasonable in magnitude; not perpetual but alternately rewarding.

A Suggestion

The preposition in this connection is that the magnitude of deficit in each year of a Five Year Plan should be pre-planned.

DISTRIBUTION OF DEFICIT FINANCING



It should gradually increase from lowest in the first year and attaining its highest level in the third year and then again gradually receding to lowest in the last year. In this way if X units of expenditure is financed through deficit financing in the first year of the Plan, its magnitude should be 2 X units during the Second year, 3 X units during the third year and again 2 X units and X units respectively during the last two years. The total will thus be 9 X units. This suggests that one-ninth of the total magnitude of deficit financing over the five year period, should be used in the first year and accordingly during the remaining years.

Such a scheme will bring about deflationary tendencies in the first and the fifth year of the five year plan and gradually rising and then declining inflationary tendency during the second, third and the fourth years. In this way economy can get all the benefits of an inflation without the danger of getting into the grip of hyper or spriral inflation.

This scheme will have another additional distinct advantage when it is implemented with the scheme of gradually increasing taxation, already suggested in the foregoing pages. It can be noted that taxation and deficit financing both continue increasing during the first three years. After that magnitude of deficit financing declines whereas taxation continues to go up. The combination helps to provide incentive during the first three years by creating inflation and then again shifting reliance gradually to sound resources. This scheme helps to keep a check on inflation in the economy. Declining deficit financing and increasing taxation during the last two years will serve to wipe out the existing inflationary pressure. This can help in providing the next plan a sound footing.

This is, no doubt, true that such schemes can not be implemented with exactness but this marks a definite trend to ensure a more effective handling of fiscal instruments with the long term point of view.

Measures for combating inflation

As mentioned earlier, the process of economic development and the policy of redistribution etc. are themselves inflationary. With these, increase in money supply as a result of deficit financing calls for the adoption of counter inflationary measures. Suggested measures in this connection[1] are: The alleviation of goods shortage; sales of gold and payment of loans in gold by Government; increase in Government revenues; public savings; direct price control on articles of necessity;[2] increased imports; check in exports[3] etc.

1. Mobilisation of Domestic Capital: Report and Documents of the First Working Party of Experts; United Nations, ECAFE. Pages 72-76.
2. Ibid; P. Ungphakorn and R. Suvaranist of Ministry of Finance, Government of Thailand.
3. Ibid; United Kingdom Delegates.

The measures suggested above are doubtlessly effective in curbing down inflation, but during the course of economic development of an underdeveloped country, sales of gold and payment of loans in gold, increased imports and reduction of exports etc. can not be resorted. Thus, following measures can be adopted to combat inflation in an underdeveloped country -

1. Self sufficiency(increased production) in respect of the articles of necessity;
2. Commodity taxation on the articles of secondary importance. Gradually increasing rates of taxation of luxuries; and
3. Intensification of the small scale movement, especially among the poor people.

On the lines traced above, deficit financing can be used as an active and a profitable instrument for financing the economic development.

CHAPTER XXII

SMALL SAVINGS

The success of receipts under the head of small savings, during the past ten years of India's planned economic development, has amply justified the fruitfulness of having a decentralised system for organising the small savings movement, though the target in this respect was not fulfilled during the Second Five Year Plan. This shortfall need not be a cause of much anxiety because targets of sources like small savings, loans from the public etc. can only be fixed on the basis of trial and error method. India is a country with a very large percentage of poor population. The other difficulty is that the population is scattered over a large number of small villages stretching all over the country. Under these circumstances, it naturally requires the movement to be organised with its net-work stretching all over the country. The policy of promoting it through the cooperation of States has been appreciable and it benefitted with much success.

Another remarkable feature in this respect was that the modes of savings were introduced to suit all type of savers with different saving capacities. Hoever, a slight shortfall on this account during the Second Plan was due to the lack of popularity of this movement.

Before suggesting measures for making the small savings' movement a greater success in future, it would be apropos to enumerate the causes which serve as handicaps in this respect. Mainly they are:

1. Poverty - The foremost reason is poverty. A large part of Indian population lives at or even far below the level of subsistance. Their capacity to save is nil. Among the various reasons of their poverty are primary and obsolete methods of produc-

tion, ancestral debts, big families to support and large religious and customary expenses etc.

2. Illiteracy - The second reason is their illiteracy. For this reason they lack fore sight; they lack incentive to work more; and they do not understand the advantages of savings.

Again, they remain uninformed of the savings facilities made available to them by the Government. It is very difficult to make them understand the advantages of savings. It is all the more difficult for them to take confidence in the savings institutions.

3. Carelessness to save small amounts - As it has already been mentioned, even those who can save, have a very low propensity to save. For example there are a large number of people who are in a position to make small savings, so as to avail the 25 n.p. savings stamps scheme of the Government. But there is practically no reason for them to show anxiety to purchase one or two 25 n.p. stamps and wait till the number of such stamps becomes 20. Then they can get one savings certificate of the denomination of Rs.5. So much of botheration for the interest they get on it, is of no value to them. With little savings one cannot hope to do any thing in future. They prefer to consume the little amount than to lock it for a period of, say, 12 years.

On the other hand illiteracy is also responsible for the lack of higher values and national character in them. A common man cannot think of saving purely with the national point of view. In short, absence of optimism, foresight and national character, confront the small savings' movement as greatest handicaps.

4. Large non-monetised sector - Like most of the under-developed countries, India, too has a very limited monetised sector. Greater part of the population lives in villages where the barter system is prevalent and money is not used by them as a means of exchange of commodities. Their economy is mainly agrarian and they produce only as much as they can consume. Expecting a monetary saving from them is obviously out of question.

Now, having discussed the nature of handicaps, measures to improve the small savings' movement can be suggested. They would be of the following types:

(1) Measure to increase the propensity to save.

(2) Measure to publicise the issue and educate people.

(3) Approach to common people.

(4) Savings from the non-monetised area.

Coming to the first point it is easy to understand that if incomes of the poor people increase, their propensity to save would automatically increase. In India, several measures were taken to improve the living and working conditions, especially of the poor. Measures consisted of preservation of crop from damage, training for the use of better and improved method and techniques of production; measures to develop and expand small scale and cottage industries with a view to provide full or part time occupations to the unemployed; making provisions to give loans so that poor workers may improve their working conditions by pruchasing better working equipment and wiping out their ancestral debts etc.

These measures have already come to be used in our country. Though it would take some time for these measures to give successful results yet, they form a sound and a desirable footing

for vitalising the small savings movement in the coming years.

In the second place, spread of education is necessary. In the words of the United Nations' experts "steps should be taken to combat the ignorance, illiteracy and conservatism of the rural population and the habits of thrift should be promoted to the largest possible extent." This message can be taken deep into villages through the gram-sevaks. They should be entrusted to widen the knowledge of common people and tell them the advantages of saving. An approach through the rural workers can prove to be very fruitful in respect of popularising the cause of small savings, especially among the people living in villages.

Thirdly an organised approach to the savers of small amount seems quite necessary. There are quite a large number of people in our country who, if pursuaded, can save little amounts. These little amounts would be of little importance to the individuals but of great value for the nation. An individual himself, would hardly care to save a diminutive amount but if properly approached, these insignificant savings by numerous savers all over the country, would make a substantial amount to finance the country's development.

Such an approach can be organised by further developing institutions like insurance, post offices and cooperatives and vitalising their activities.

Lastly, there comes the problem of dealing with the non-monetised sector. As already mentioned, people forming the non-monetised sector, make savings in terms of time and energy. Their wants are few. They produce only that much what they themselves consume. Underemployment in villages is quite common in our country.

People have surplus time and energy, which generally goes a waste.

If this surplus emergy be employed through shramdan to finance the development schemes (rural), a good deal of saving can be made in the development expenditure. This would indirectly mean the mobilising of savings, in monetary terms, from the non-monetised sector. People can easily be convinced to work for the welfare of their villages.

Much has already been done to make the small savings' movement, in our country, a success. The need of the present time is to popularise it, organise it to approach common people in such a fashion that all savings, even very small ones, may be properly utilised; and to make use of the savings that can be obtained from the non-monetised sector of our economy.

APPENDIX

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